MISSISSIPPI LAW JOURNAL

IN MEMORIAM: EARL W. DeHART

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EDITOR'S NOTE: In Volume 47, Number 5, at page 943, we inadvertently failed to denote that Mr. Thomas Vocino is currently serving as the Head of the Department of Government, Auburn University at Montgomery and that Colonel John H. Morris' present position is Director of Transportation, the Pentagon.

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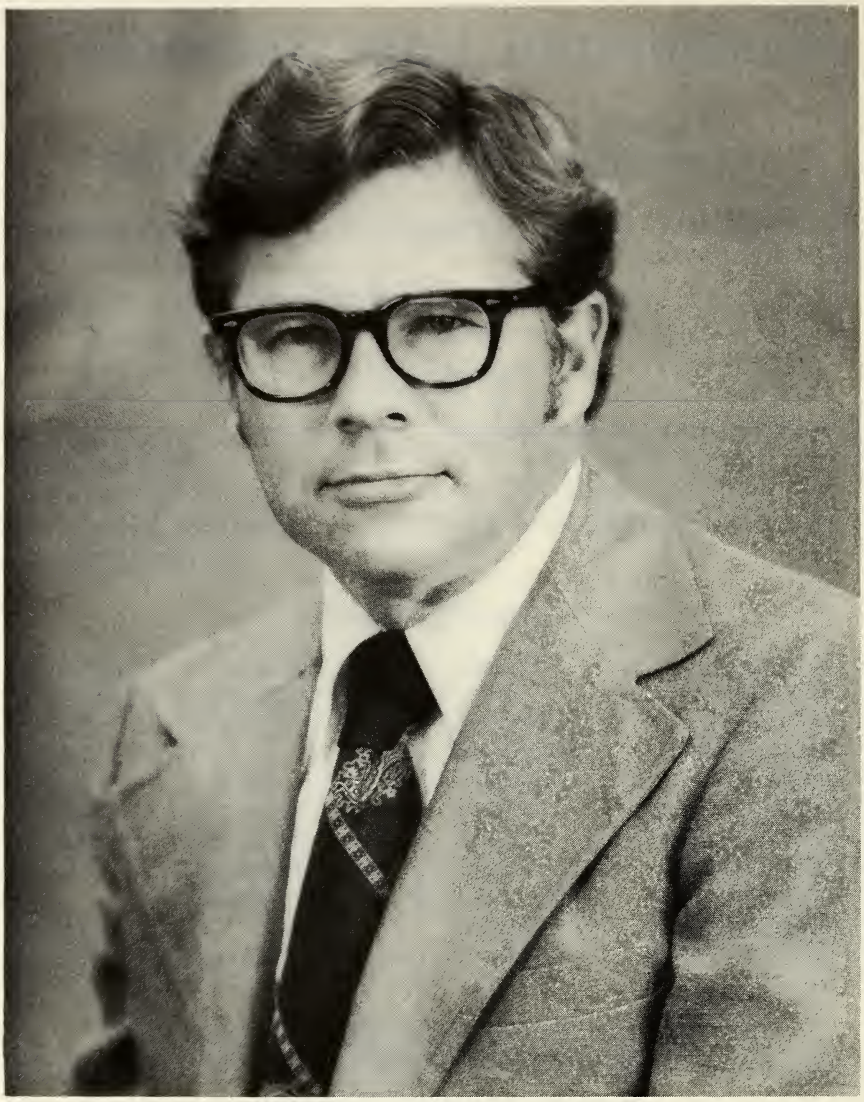

IN MEMORIAM: EARL W. DeHART

Words fail when one tries to express the spirit of this life that is now silent. Earl W. DeHart, born in Meherrin, Virginia, May 13, 1933, died January 29, 1977.

From 1972 until his death, Earl DeHart taught labor law at the University of Mississippi. Every Thursday afternoon he would drive or, weather permitting, fly from Memphis to his class. A lawyer's lawyer, Earl DeHart was also a student's lawyer. Labor law was a field he had thoroughly mastered and his brilliance, his practical experience, and his homespun wit combined to charm and sparkle the ordinary. Under his tutelage, a field foreign and unglamorous to most became a subject of fascination as he shared his courtroom experiences and "nuts and bolts" practicality. As much as he was a teacher, Earl DeHart was also a friend. With pipe in hand he would stand in the halls or on the entrance steps of the law school and give to others a most valuable commodity: himself—unhurried, patient, tolerant, practical, wise. Earl loved teaching at Ole Miss and never would have surrendered it voluntarily.

Earl taught in another way too: Sunday School at Eudora Baptist Church. To Earl, letting the Spirit of Jesus Christ live through him was never "pushy" or "preachy." His classes were sincere but relaxed. Yet, the spiritual encounter was real. Class members sought his company as well as his teaching.

Earl was a master of the courtroom. His always calm and ease of manner and his unfailing courtesy belied a tough and perceptive intellect that moved quickly to the jugular vein of a problem. Earl was also a master at labor negotiations. When the atmosphere became tense, puffing on his ever-present pipe, he was able to break down the barriers with a well-timed anecdote or reminiscence. His opponents spoke of him both as the toughest competitor they ever faced and the nicest person with whom they ever dealt.

A superb writer, Earl DeHart would marshal his thoughts, begin to write, and not lay down his pen until he had finished his Brief or Statement of Position. He never looked back. The original product became the final product, as finished and complete as if it had been revised and redrafted many times over.

His law partners and associates suffer Earl's absence like a brother. He always had time to talk. One never felt hurried in his presence. He was a master of the law and yet he was careful about displaying it, always sensitive to the other person's feelings. A lawyer's lawyer, Earl was also a lawyer's friend.

Earl's encyclopedic knowledge in so many fields reflected his insatiable curiosity and interest in people and the world about him. He loved

the outdoors. He loved to go fishing. With his boat and motor and a friend at his side, he would put out on a Sunday afternoon for Sardis or some other lake. He was a sought-after hunting companion and during duck season his days at the office started late because the hunting days started early.

Those who dared came to his house for ping-pong. Deftly and to their chagrin he would trim their paddle without putting down his pipe. As for pool, his early days in earning his way through college by cleaning a poolhall made him an expert by any ordinary standard.

And flying, oh how he loved to fly. Blue skies called to him. He first shared a plane, then he owned his own plane, and it was a plane that killed him. Saturdays would find him at the airport and if he couldn't fly he could talk about it. And every place friends. Friends whose only source of contact and whose only common interest was where Earl DeHart encountered them. Friends who sought him when he was alive and who miss him deeply now that he is gone.

> Earl W. DeHart, born Meherrin, Virginia, May 13, 1933; admitted to bar, 1958, Virginia; 1963 Tennessee. Preparatory education, University of Virginia (B.S., 1955); Legal education, University of Virginia (LL.B., 1958). Adjunct Professor of Law, Labor Law, University of Mississippi, 1972-1977. Field Attorney, National Labor Relations Board, 1958-1960. Legal Assistant to Member, National Labor Relations Board, 1961-1963. Member: Memphis and Shelby County and American Bar Associations; Virginia State Bar; Director, West Tennessee Sportman Club; Eudora Baptist Church.

The obituary is so cold. Gone is the warm smile. Gone is the friendly word. Yet, who of his friends will ever look at the blue skies Earl loved without thinking of him—our colleague, our teacher and our mentor.

A Friend

WHAT IS A SECURITY?: A CRITICAL ANALYSIS

*William H. Newton III**

Over forty years after the adoption of the Securities Act of 1933[1] and the Securities Exchange Act of 1934,[2] the controversy surrounding what constitutes a security still rages. Shrouded in ambiguity,[3] this conundrum may evoke entertaining legal pirouettes for academic discussion; however, from the pragmatic viewpoint of counsel whose client proposes to raise funds by a public offering, this matter mandates clarity, not confusion. If a security exists within the definitional sections[4] of the

---

* B.S. 1967, Mississippi State University; M.S. 1968, Massachusetts Institute of Technology; J.D. 1972, Southern Methodist University; Associate, Blackwell, Walker, Gray, Powers, Flick & Hoehl, Miami, Florida.

[1] 15 U.S.C. §§ 77a *et seq.* (1970).

[2] 15 U.S.C. §§ 78a *et seq.* (1970).

[3] *See, e.g.,* Ivan Allen Co. v. United States, 422 U.S. 617, 642 (1975) (referring to the Supreme Court's ambiguous use of the term "securities").

[4] The term "security" is defined by the Securities Act of 1933 as follows:

> When used in this subchapter, unless the context otherwise requires—
>
> (1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Securities Act of 1933, § 2(1), 15 U.S.C. § 77(b)(1) (1970).

The Securities Act of 1934 defines the term "security" as follows:

> (a) When used in this chapter, unless the context otherwise requires—
>
> . . .
>
> (10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78c(10) (1970).

federal acts, the offering is subject to registration with the Securities and Exchange Commission (SEC), provided there is a "sale"[5] and the exemption provisions[6] do not otherwise apply. Further, while the offer may be exempt from registration, the presence of a security may nevertheless trigger the fraud provisions.[7] The problem thus posed is clear-cut—what are the parameters delineating a security under federal law?

I. The Policy of the Securities Provisions

After lengthy committee hearings and extensive debate, Congress enacted the federal securities provisions to remedy the practices and abuses which precipitated the stock market crash of October 1929.[8] To correct these abuses, Congress sought to implement a twofold policy. Initially, an attempt was made to place investors on an equal footing with respect to investment decisions through full and fair disclosure of all relevant information concerning the future of the issuer and the value of the offered security.[9] In contrast to most "blue sky" laws, Congress rejected the merit regulation notion that the inability of investors to analyze and comprehend available financial data requires that an independent evaluation of the risk inherent in a proposed offering be made for them.[10] Also, Congress attempted to prevent further exploitation of the public by misrepresentation through the sale of unsound, fraudulent and worthless securities.[11] To fully implement these policies, the federal

---

While minor variations between the two definitions of a security exist, the Supreme Court has remarked that they are "virtually identical." Tcherepnin v. Knight, 389 U.S. 332, 336, 342 (1967); *see* S. Rep. No. 792, 73d Cong., 2d Sess. 14 (1934).

The existence of a "security" is a jurisdictional predicate to the applicability of the federal securities provisions. *See* Woodward v. Metro Bank of Dallas, 522 F.2d 84, 91 (5th Cir. 1975) (1934 Act); Blackwell v. Bentsen, 203 F.2d 690, 691 (5th Cir. 1953) (1933 Act). If jurisdiction over a federal securities claim exists, the court may exercise jurisdiction over a pendent state-law cause of action. *See, e.g.*, Vanderbroom v. Sexton, 422 F.2d 1233, 1241-42 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970); Smith v. Manausa, 385 F. Supp. 443, 446 (E.D. Ky. 1974). The existence of a security, however, need not be established prior to the issuance of a subpeona duces tecum by the SEC. SEC v. Savage, 513 F.2d 188, 189 (7th Cir. 1975); SEC v. Brigadoon Scotch Distribs., Ltd., 480 F.2d 1047, 1052-55 (2d Cir. 1973), *cert. denied*, 415 U.S. 915 (1974).

[5] Securities Act of 1933, § 2(3), 15 U.S.C. § 77b (3) (1970).

[6] Securities Act of 1933, §§ 3, 4, 15 U.S.C. §§ 77c, -d (1970).

[7] Securities Act of 1933, § 17(a), 15 U.S.C. § 77q(a) (1970); Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (1970).

[8] *See* Loomis, *The Securities Exchange Act of 1934 and the Investment Advisors Act of 1940*, 28 Geo. Wash. L. Rev. 214 (1959).

[9] *See* El Khadem v. Equity Sec. Corp., 494 F.2d 1224, 1227 n.7 (9th Cir.), *cert. denied*, 419 U.S. 900 (1974); S. Rep. No. 47, 73d Cong., 1st Sess. 1 (1933).

[10] *See* 11 Sowards, Business Organizations—The Federal Securities Act §§ 1.01, -.02 (1975); Mofsky, *Reform of the Florida Securities Law*, 2 Fla. St. L. Rev. 1 (1974).

[11] S. Rep. No. 47, 73d Cong., 1st Sess. 1 (1933).

courts have placed substance over form to analyze the economic realities underlying a given financial transaction. In doing so, the term "security" has been expanded beyond its traditional definition.

II. Substance is Controlling Over Form

The leading decision disregarding form for substance so as to require application of the federal securities provisions was rendered by the Supreme Court in *SEC v. W. J. Howey Co.*[12] In *Howey,* the defendants publicly offered small parcels of a citrus grove coupled with an optional contract for harvesting and marketing the produce.[13] Prospective purchasers were advised that development of the parcels would not be economically feasible unless the optional service arrangements were included.[14] Accordingly, the vast majority of purchasers, most of whom were not Florida residents and lacked the expertise necessary for citrus development, purchased service contracts from the promoters as well as the land.[15] All of the produce was pooled for sale and the promoters disbursed each purchaser's share of the net proceeds in accordance with the output from each parcel.[16]

In finding the existence of a security, the Court formulated what has become the classic definition of the term "investment contract": "The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."[17]

Subsequent to *Howey*, the definition of an investment contract has been equated with other federal statutory phrases defining subclasses of securities.[18] More recently, however, the Court in *United Housing Foundation v. Forman*[19] reaffirmed the *Howey* test in finding "no distinction" between an "investment contract" and "an instrument commonly known as a 'security.' "[20] Other phrases within the federal provisions ultimately may require the application of a different criterion. For

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[12] 328 U.S. 293 (1946), *noted in* 46 Colum L. Rev. 885 (1946).

[13] 328 U.S. at 295.

[14] *Id.*

[15] *Id.* at 296.

[16] *Id.*

[17] *Id.* at 301. If this test is satisfied, "it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property, with or without intrinsic value." *Id.*

[18] *See, e.g.*, McCown v. Heidler, 527 F.2d 204, 208-09 (10th Cir. 1975)(interests in real property); Swank Fed. Credit Union v. C. H. Wagner & Co., Inc., 405 F. Supp. 385, 388-89 (D. Mass. 1975) (bank certificates of deposit); Bayound v. Ballard, 404 F. Supp. 417, 422 (N.D. Tex. 1975)(interests in oil and gas leases).

[19] 421 U.S. 837 (1975).

[20] 421 U.S. at 852.

present purposes, however, where form is disregarded for substance so as to require application of the federal securities provisions to a given financing device, the *Howey* test typically will be in issue.[21]

The substance-over-form concept has also been applied to exclude certain financing devices from the requirements of the federal securities statutes. In *Forman,* purchasers of certain "stock"[22] were granted an option to lease an apartment in "Co-op City," a state-subsidized, nonprofit housing cooperative in New York City. Each purchaser was required to buy eighteen shares of "stock" for each apartment room at a fixed cost of $25 per share or a total cost per room of $450.[23] An "Information Bulletin" issued prior to construction of Co-op City projected the average monthly rental cost at $23.02 per room.[24] Inflationary pressures, however, forced actual construction costs to soar substantially above initial estimates. Consequently, the average monthly rental charge rose to $39.68 per room.[25] Alleging misrepresentation through the "Information Bulletin," tenants filed a class action under federal and state securities provisions seeking in excess of "$30 million in damages, forced rental reductions, and other appropriate relief."[26]

The United States Court of Appeals for the Second Circuit adopted the "literal approach" in holding that the mere use of the word "stock" in connection with the transaction triggered the federal securities provisions.[27] On appeal, the United States Supreme Court looked to the economic realities and reversed.[28] Close examination of the disputed trans-

---

[21] The *Howey* test arguably should be adopted as the generic definition denoting all phrases describing a security under the federal statutes. There are, nevertheless, instances where a security should be held to exist despite the fact that the *Howey* test is not satisfied. For example, the issuance of stock to executive personnel of the issuer should constitute the sale of a security irrespective of the fact that such personnel do not rely solely upon the efforts of others for their expectation of profit. *See, e.g.,* Bronstein v. Bronstein, 407 F. Supp. 925, 926-27 (E.D. Pa. 1976).

[22] There was no clear indication from the record why the term "stock" was used. The Court, however, pointed out that such use appeared to be merely "a matter of tradition and convenience." 421 U.S. at 848 n.13.

[23] *Id.* at 842.

[24] *Id.* at 843.

[25] *Id.* at 844.

[26] *Id.*

[27] Forman v. Community Servs., Inc., 500 F.2d 1246, 1252 (2d Cir. 1974), *rev'd sub nom.,* United Hous. Foundation, Inc. v. Forman, 421 U.S. 837 (1975); *see* 1050 Tenants Corp. v. Jakobson, 503 F.2d 1375 (2d Cir. 1974).

[28] 421 U.S. 837 (1975). In bringing their action, the purchasers had relied upon dicta in SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943), to the effect that instruments "may" be included within the definition of a security as a matter of law, "if on their face they answer to the name or description" thereof. *Id.* at 351. Consequently, a security "might" be shown by proving the document itself. The *Forman* Court concluded that such reliance was misplaced since use of the conditional words "may" or "might" made clear

actions revealed that, despite their label, the shares possessed none of the characteristics traditionally associated with stock, including the most fundamental feature—the expectation of profit.[29] Because the economic realities revealed that "the inducement to purchase was solely to acquire subsidized low-cost living space . . . not to invest for profit,"[30] a security under the federal statutes could not exist.

The resulting application of the substance-over-form concept for the purpose of excluding coverage of the federal statutes was forecast in cases involving promissory notes. Indeed, under the "literal approach" inclusion of the term "notes" within the federal definitional sections[31] would require finding a security in every transaction involving a promissory note. Such a result is not, however, in keeping with one of the central purposes of the securities laws[32] and has met with disfavor in the courts. In *Lino v. City Investing Co.*,[33] for example, a purchaser tendered his personal promissory notes to a promoter in exchange for the right to operate a franchise sales center. The court pointed out that the introductory phrase to the definitional sections of both the 1933 and 1934 Acts—"unless the context otherwise requires"—mandates an examination of the factual context in which the transaction occurred to determine whether it fell within the intended scope of the federal securities provisions.[34] Such an examination of the transaction in *Lino* revealed none of the attributes typically associated with an investment.

---

that *Joiner* had not established "an inflexible rule barring inquiry into the economic realities underlying a transaction." 421 U.S. at 849-50. The Court pointed out that with the exception of the Second Circuit, the "literal approach" had been rejected by every court of appeals to consider the issue. *Id.* at 849 n.14.

In *Howey*, the substance-over-form approach was engaged to bring within the securities provisions items not ordinarily considered as securities but nevertheless having the same substantive characteristics. The substance-over-form approach in *Forman* properly excludes from those provisions items which, though labeled as "securities," possess none of their substantive characteristics.

[29] *Id.* at 851.

[30] *Id.*

[31] See note 4 *supra*.

[32] *See* Tcherepnin v. Knight, 389 U.S. 332, 336 (1967). In every case involving a promissory note, the central issue is whether the plaintiffs are simply unprotected borrowers involved in a commercial transaction or investors entitled to protection. C. N. S. Enterprises, Inc. v. G. & G. Enterprises, Inc., 508 F.2d 1354, 1359 (7th Cir.), *cert. denied*, 423 U.S. 825 (1975). *See also* Zabriskie v. Lewis, 507 F.2d 546 (10th Cir. 1974) (promissory notes given to procure funds for corporation were securities); McClure v. First Nat'l Bank, 497 F.2d 490 (5th Cir. 1974), *cert. denied*, 420 U.S. 930 (1975) (promissory notes of 1-year maturity issued for bank loan to pay corporate obligation not securities); Bellah v. First Nat'l Bank, 495 F.2d 1109 (5th Cir. 1974) (promissory notes of 6-month maturity secured by deed of trust and issued for bank loan to aid makers in development of livestock business not securities).

[33] 487 F.2d 689 (3d Cir. 1973).

[34] *Id.* at 694. In interpreting the federal acts, courts are to be guided by the traditional

> In no way could City Investing be said to have "purchased" Lino's notes for speculation or investment. City Investing was selling a certain contract right to Lino, not buying his security. It simply lacks common sense to describe the transaction as City Investing purchasing John Lino's security by paying him the right to operate one of its Franchise Sales Centers.[35]

Despite inclusion of the term "notes" in the federal securities provisions, the transaction was by nature strictly commercial. Therefore, an investment was not present and a security did not exist.[36]

Placing substance over form for the purpose of excluding coverage under the federal statutes, however, is severely tempered by the consideration which must be accorded the reasonable expectations of the investor. As the Supreme Court has pointed out, the criteria to be applied in determining the existence of a security include

> what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held

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rule of statutory construction "that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers." Church of the Holy Trinity v. United States, 143 U.S. 457, 459 (1892). *See also* United States v. American Trucking Ass'ns, Inc., 310 U.S. 534, 543 (1940).

[35] 487 F.2d at 695.

[36] *Id.* In what is now termed "the commercial-investment dichotomy," courts are required to examine the particular factual context to determine whether the transaction is commercial or investmental in nature. While the delineation between the two is not always clear, the extremes of each have been conceptually identified.

> [B]uying shares of the common stock of a publicly-held corporation, where the impetus for the transaction comes from the person with the money, is an investment; borrowing money from a bank to finance the purchase of an automobile, where the impetus for the transaction comes from the person who needs the money, is a loan.

C. N. S. Enterprises, Inc. v. G. & G. Enterprises, Inc., 508 F.2d 1354, 1359 (7th Cir.), *cert. denied*, 423 U.S. 825 (1975). The gray area in between requires case-by-case analysis. *See, e.g.*, Comment, *Commercial Notes and Definition of "Security" Under Securities Exchange Act of 1934: A Note Is a Note Is a Note?*, 52 NEB. L. REV. 478 (1973) (offering possible criteria for distinguishing commercial and investment notes). Possible bases for application of "the commercial-investment dichotomy" include: (1) subjecting commercial loans to the registration requirements of the federal acts "would inevitably wreak havoc on the commercial paper market;" and (2) commercial loan transactions should find recourse in state rather than federal courts. Bellah v. First Nat'l Bank, 495 F.2d 1109, 1114 (5th Cir. 1974); *see* ALI STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS I (1969).

While the policy of full and fair disclosure arguably should apply to commercial as well as investment transactions, it is clear that the federal securities provisions were not intended to protect the former. *See* H.R. REP. No. 85, 73d Cong., 1st Sess. 3 (1933); S. REP. No. 47, 73d Cong., 1st Sess. 1 (1933). After weighing the costs, Congress should have the ultimate authority to determine if any regulation of commercial transactions is necessary. In this regard, any such regulation may be undesirable in an area typically controlled by the states. *See generally* Note, *The Controlling Influence Standard in Rule 10b-5 Corporate Mismanagement Cases*, 86 HARV. L. REV. 1007, 1037 n.130 (1973).

> out to the prospect. In the enforcement of [the federal acts] it is not inappropriate that promoters' offerings be judged as being what they were represented to be.[37]

Because both the offer and sale of a security trigger jurisdiction under the federal acts,[38] it is immaterial for jurisdictional purposes "that some purchasers choose not to accept [a] full offer"[39] embodying all *Howey* components. The offer, which generally is held to include sales literature and promotional materials as well as the final agreement between parties,[40] must be analyzed in light of the investors' reasonable expectations[41] at the time of the offer.[42] While the legal characterization of the transaction is not binding,[43] skillful drafting of documents involved in the offering may preclude the existence of a security. Furthermore, if the terms of the offer and acceptance are ambiguous, additional background facts may be analyzed.[44] Counsel would be well advised, however, not to risk nonregistration through reliance on *Forman*. If any doubt exists, counsel should either obtain an SEC opinion or comply with the relevant registration requirements.

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[37] SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 352-53 (1943), *noted in* 12 GEO. WASH. L. REV. 494 (1944); 17 S. CAL. L. REV. 324 (1944).

[38] SEC v. W. J. Howey Co., 328 U.S. 293, 301 (1946).

[39] *Id.* at 300; *see* SEC v. Brigadoon Scotch Distribs., Ltd., 388 F. Supp. 1288, 1290-99 (S.D.N.Y. 1975) (emphasizing that the offer rather than acceptance is determinative). *But see* Blackwell v. Bentsen, 203 F.2d 690, 693 (5th Cir. 1953).

[40] *E.g.*, United Hous. Foundation, Inc. v. Forman, 421 U.S. 837, 843 (1975) (analyzing "Information Bulletin" distributed to prospective residents of housing complex).

[41] Dissenting in *Forman*, Mr. Justice Brennan advocated adoption of the "literal approach" to avoid the inherent ambiguities in an inquiry into the purchaser's intent. *Id.* at 865 (Brennan, J., dissenting). Gauging the presence of a security, however, involves an inquiry into the objective rather than subjective intent of the purchaser. That is, the appropriate examination relates to the purchaser's reasonable expectations in light of the terms of the offer. *See, e.g.*, Miller v. Central Chinchilla Group, Inc., 494 F.2d 414, 417 (8th Cir. 1974); Bronstein v. Bronstein, 407 F. Supp. 925, 928 (E.D. Pa. 1976).

[42] If no offer is made, jurisdiction will not arise, despite subsequent actions by the purchaser or promoter which would otherwise convert the transaction into a security. *See generally* El Khadem v. Equity Sec. Corp., 494 F.2d 1224, 1228 (9th Cir.), *cert. denied*, 419 U.S. 900 (1974).

[43] See SEC v. W. J. Howey Co., 328 U.S. 293, 300 (1946); United States v. Herr, 338 F.2d 607, 610 (7th Cir. 1964).

[44] [I]n determining whether a particular instrument is an investment contract and therefore a security, inquiry does not necessarily stop with an examination of the instrument. Where the terms of the instrument are reasonably subject to varying interpretations, the background facts, including the terms of the offer, the plan of distribution and the economic inducements held out to the prospect, are to be reviewed.

Chapman v. Rudd Paint & Varnish Co., 409 F.2d 635, 640 (9th Cir. 1969), *citing* SEC v. United Benefit Life Ins. Co., 387 U.S. 202, 211 (1967); SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 352-53 (1943).

III. Analysis of the *Howey* Test

The situation posing the greatest difficulty for counsel was raised by *Howey*—where the substance of a transaction falls within the ambit of the securities provisions so as to require registration, although the form does not. The appropriate inquiry thus requires a critical analysis of each component of the *Howey* test. Those components, each of which will be closely scrutinized, are (1) an investment of money, (2) in a common enterprise, (3) with an expectation of profits, (4) solely from the efforts of others.

A. Investment of Money

The making of an investment is a necessary and fundamental prerequisite to establish the existence of any security.[45] Since one of the basic purposes of the federal provisions is to protect investors, the definition of securities under those provisions "necessarily determines the classes of investments and investors which will receive" that protection.[46] Despite the fact that all securities are investments rather than commercial transactions, not all investments are necessarily securities.

The nature of the investment is thus determinative of whether protection is to be afforded.[47] While the *Howey* test appears to envision an investment of money, investments of other types of consideration also are included if the basic economic relationships established by the test are not effectively altered.[48] In this regard, investments of a purchaser's own labor or efforts in an enterprise create the most difficulty.

Satisfaction of the *Howey* test requires that the investor's expectation of profit be realized solely from the efforts of others.[49] However, if a purchaser's investment of labor creates the necessary expectation of profit, the profits flow not only from the efforts of others but from the purchaser's efforts as well.[50] Of course, where the invested labor is merely a nominal investment, no real profit-producing efforts are expended. For example, if the purchasers in *Howey* had been required to pick an orange from their citrus parcel once a year, no profit expectation

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[45] SEC v. W. J. Howey Co., 328 U.S. 293, 299 (1946).

[46] Tcherepnin v. Knight, 389 U.S. 332, 336 (1967).

[47] SEC v. W. J. Howey Co., 328 U.S. 293, 299-301 (1946).

[48] For example, in El Khadem v. Equity Sec. Corp., 494 F.2d 1224, 1225 (9th Cir.), *cert. denied*, 419 U.S. 900 (1974), the invested capital consisted of rehypothecatable collateral and an assignable promissory note. *See also* Long, *An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulation*, 24 Okla. L. Rev. 135, 174-75 (1971) (suggesting that investment of money or "money's worth" should suffice).

[49] SEC v. W. J. Howey Co., 328 U.S. 293, 299 (1946).

[50] Note, *Securities Regulation of Pyramid Schemes*, 51 Tex. L. Rev. 788, 800 (1973).

would be created and the results would remain unaltered.[51]

On the other hand, where the purchaser's efforts are directly involved in the generation of profits, the result becomes more obfuscated. In *Hirsch v. duPont,*[52] purchasers of both general and limited partnership interests brought an action alleging that their purchases involved a violation of the fraud provisions of the federal securities statutes.[53] As general partners, the purchasers had invested their own efforts through the holding of full-time positions and active participation in the enterprise. Consequently, because the purchasers of the general partnership interests did not rely solely upon the efforts of others for their profits, but instead upon their own active participation and vote in partnership matters, the court held that their interests were not securities within *Howey.*[54] As purchasers, however, the limited partners had no rights with respect to the conduct or control of partnership business. Therefore, since they were required to rely solely upon the efforts of others for their profits, the court found that the "*limited* partnership interests clearly [satisfied] the definition of a security."[55] The question of whether the *Howey* test *requires* the type of passive investor involved in *duPont*, however, can be considered only by a thorough and critical analysis of the remaining components of that test.

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[51] *Id.* at 794; *see* Long, *supra* note 48, at 145.

[52] 396 F. Supp. 1214 (S.D.N.Y. 1975).

[53] Specifically, the amended complaint alleged that the defendant violated § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970) and § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) (1970). 396 F. Supp. at 1215.

[54] 396 F. Supp. at 1218-22; *accord,* Van Arsdale v. Claxton, 391 F. Supp. 538, 540-41 (S.D. Cal. 1975) (partnership interest in mobile home park); Mecom v. Palmer, 384 F. Supp. 1369, 1371 (W.D. La. 1974) (sale of interest in football franchise partnership). *But see* Bronstein v. Bronstein, 407 F. Supp. 925, 927 (E.D. Pa. 1976) (stock sold to officer and director of close corporation constituted security). The defendant in *Bronstein,* relying in part on *Forman,* argued that a close corporation should be equated in substance with a partnership. *Id.* at 927. The court rejected this argument, noting that "[i]n contrast to what were merely labelled shares of stock in *Forman,* the shares here are unquestionably stock." *Id.* at 928.

[55] 396 F. Supp. at 1227; *accord,* McGreghar Land Co. v. Meguiar, 521 F.2d 822, 823 (9th Cir. 1975) (limited partnership interest in land development enterprise); Kroungold v. Triester, 407 F. Supp. 414, 417 (E.D. Pa. 1975) (sale of limited partnership interest in real estate venture); Weinberger v. New York Stock Exch., 403 F. Supp. 1020, 1028 (S.D.N.Y. 1975) (limited partnership interest in brokerage firm); SEC Release No. 33-4877, 32 Fed. Reg. 11705 (1967). *See also* Van Arsdale v. Claxton, 391 F. Supp. 538, 540 (S.D. Cal. 1975) (distinguishing purchase of entire partnership interest and limited partnership interest).

B. Common Enterprise

The presence of a common enterprise is basic to the existence of a security.[56] The key to determining the presence of a common enterprise is the degree of control retained by the investor over the factors contributing to the venture's ultimate success.[57] Determining the precise degree of retained control can be accomplished by analyzing the investor's expertise and the economic feasibility of individual exploitation.[58] Moreover, even if the investor retains some right of control, the presence of other investors, *e.g.*, where pooling exists, may make that right so attenuated that his control over the chances of success is de minimus.[59]

Courts frequently attempt to define the common enterprise requirement in vague generalities without explaining the rationale underlying their decisions.[60] For example, while the Court in *SEC v. C. M. Joiner Leasing Corp.*[61] did not expressly mention the term "common enterprise," the essential ingredients of the test were succinctly captured. In *Joiner*, the defendant sold assignments of oil leases on small parcels of land and represented that it would drill a test well on the property.[62] Essentially pointing out the components of a common enterprise, the Court stated:

> The exploration enterprise was woven into these leaseholds, in both an economic and a legal sense; the undertaking to drill a well runs through the whole transaction as the thread on which everybody's beads were strung.[63]

If the economic inducement had not included the seller's pledge to drill the exploration well, the purchasers would have been left to realize profits on their own initiative and no security would have been present. Also, in *Tcherepnin v. Knight,*[64] the Court, holding withdrawable capital shares in a state savings and loan association to be securities, described the common enterprise as follows:

> Petitioners are participants in a common enterprise—a money-lending operation dependent for its success upon the skill and efforts of the management of City Savings in making sound loans.[65]

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[56] Tcherepnin v. Knight, 389 U.S. 332, 338 (1967); SEC v. W. J. Howey Co., 328 U.S. 293, 299 (1946); SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943).

[57] Tcherepnin v. Knight, 389 U.S. 332, 338 (1967), *citing* SEC v. W. J. Howey Co., 328 U.S. 293, 301 (1946).

[58] *See generally* Note, *supra* note 50.

[59] *See* Long, *supra* note 48; Note, *supra* note 50.

[60] *See, e.g.*, Mitzner v. Cardet Int'l, Inc., 358 F. Supp. 1262, 1265 (N.D. Ill. 1973) ("little doubt" as to common enterprise).

[61] 320 U.S. 344 (1943).

[62] *Id.* at 346.

[63] *Id.* at 348.

[64] 389 U.S. 332 (1967).

[65] *Id.* at 338.

A more concise definition of a common enterprise was enunciated in *SEC v. Glenn W. Turner Enterprises, Inc.*[66]

> A common enterprise is one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties.[67]

The basic component of a common enterprise, evident in each of these cases, is the "dependency" of the investor's fortunes upon the efforts and degree of success of others. The notion of dependency thus involves an agency analysis. If the promoter is a mere agent of the investor, the investor's success is not dependent upon the efforts of others. Instead, the fortunes of the investor, by virtue of his right to control his agent—the promoter—are dependent solely upon the investor's personal efforts. On the other hand, if the promoter vis-à-vis the investor is a principal, the investor has no right to control his activities.[68] Accordingly, the investor's fortunes would be dependent upon the efforts of others. Thus, in the former situation, the *Howey* test may not be satisfied despite the existence of a common enterprise.

Evidence tending to establish whether a promoter is an agent or a principal includes investor expertise and the economic feasibility of individual exploitation.[69] If both factors are present, the conclusion that the promoter is a principal and that a common enterprise exists is strong. Where only one of the two indicia are present, however, resolution of the question is more difficult. For example, in *Howey,* the purchasers' lack of expertise and the small size of the citrus parcels rendered individual exploitation infeasible under any circumstances.[70] If

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[66] 474 F.2d 476 (9th Cir.), *cert. denied,* 414 U.S. 821 (1973), *noted in* 27 U. MIAMI L. REV. 487 (1973); 39 MO. L. REV. 283 (1974).

[67] 474 F.2d at 482 n.7, *citing* Los Angeles Trust Deed & Mortgage Exch. v. SEC, 285 F.2d 162, 172 (9th Cir. 1960), *cert. denied,* 366 U.S. 919 (1961).

[68] *See, e.g.,* Jenson v. Continental Financial Corp., 404 F. Supp. 792, 802 (D. Minn. 1975) (gold and silver coins constituted securities). Several courts have relied upon the investor-promoter relationship to determine the existence of a "common enterprise." *E.g.,* SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 478-79 (5th Cir. 1974) (sale of franchises); Glen-Arden Commodities v. Costantino, 493 F.2d 1027, 1034-35 (2d Cir. 1974) (scotch whiskey); Continental Marketing Corp. v. SEC, 387 F.2d 466, 470 (10th Cir. 1967), *cert. denied,* 391 U.S. 905 (1968) (live beavers); Los Angeles Trust Deed & Mortgage Exch. v. SEC, 285 F.2d 162, 168 (9th Cir. 1960), *cert. denied,* 366 U.S. 919 (1961) (trust deeds); Marshall v. Lamson Bros. & Co., 368 F. Supp. 486, 489 (S.D. Iowa 1974) (discretionary commodity futures trading account); Mitzner v. Cardet Int'l, Inc., 358 F. Supp. 1262, 1264 (N.D. Ill. 1973) (sale of distributorships).

[69] *See, e.g.,* Mr. Steak, Inc. v. River City Steak, Inc., 460 F.2d 666, 670 (10th Cir. 1970) (no security where informed investor purchased and assumed control of franchise operation); Los Angeles Trust Deed & Mortgage Exch. v. SEC, 285 F.2d 162, 168 (9th Cir. 1960), *cert. denied,* 366 U.S. 919 (1961).

[70] SEC v. W. J. Howey Co., 328 U.S. 293, 299-300 (1946).

the purchasers were to realize any profit, the existence of a common enterprise managed and controlled by the promoter or other third parties was essential.[71] Nevertheless, if the promoter can establish that even though the investor lacks personal expertise the investor can exploit his investment through the independent hiring of agents, the existence of a common enterprise may be rebutted.

The agency concept as it relates to the finding of a common enterprise is aptly illustrated by a comparison of discretionary and nondiscretionary commodity accounts. If an investor retains absolute authority to manage and control the account and has the power to direct the broker in the purchase of commodities, such an account is obviously nondiscretionary. Since control in a nondiscretionary account is vested solely within the investor, a "common enterprise" does not exist, and the commodities contract cannot be termed a "security" under *Howey*.[72] Alternatively, the investor and broker may agree to establish a discretionary account by vesting the management and control of the commodities account solely within the discretion of the broker. In that event, a common enterprise may be found to exist since the chances for success are dependent upon the broker's independent investment expertise.[73]

Under certain circumstances, however, courts have concluded that a discretionary trading account is not a security because of the lack of a common enterprise. In *Milnarik v. M-S Commodities, Inc.*,[74] plaintiffs argued that since other customers had entered into similar discretionary accounts with the defendant, their collective investments satisfied the common enterprise requirement.[75] The court disagreed, noting that although the defendant "entered into similar discretionary arrangements with other customers, the success or failure of those contracts had no direct impact on the profitability of plaintiffs' contract."[76] Consequently, the court found that the plaintiffs' contract created an "agency-for-hire" rather than a common enterprise.[77] The court bolstered its finding by noting that

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[71] *Id.* at 300.

[72] *See, e.g.*, Jenson v. Continental Financial Corp., 404 F. Supp. 792, 803 (D. Minn. 1975); Berman v. Dean Witter & Co., Inc., 353 F. Supp. 669, 671 (C.D. Cal. 1973); McCurnin v. Kohlmeyer & Co., 340 F. Supp. 1338, 1341-42 (E.D. La. 1972), *aff'd*, 477 F.2d 113 (5th Cir. 1973); Sinva, Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 253 F. Supp. 359, 365-67 (S.D.N.Y. 1966). *See also* Campbell, *Trading in Futures Under the Commodity Exchange Act*, 26 GEO. WASH. L. REV. 215 (1957).

[73] *See, e.g.*, Ramsey v. Arata, 406 F. Supp. 435, 438 (N.D. Tex. 1975) (broker used computer to invest); Berman v. Orimex Trading, Inc., 291 F. Supp. 701, 702 (S.D.N.Y. 1968)(cocoa futures); Maheu v. Reynolds & Co., 282 F. Supp. 423, 429 (S.D.N.Y. 1967) (discretionary joint account).

[74] 457 F.2d 274 (7th Cir.), *cert. denied*, 409 U.S. 887 (1972).

[75] 457 F.2d at 275.

[76] *Id.* at 276.

[77] *Id.* at 277.

> "[n]o claim is made that [the defendant] traded in a uniform manner for each of these accounts. Even if he had so uniformly traded, no pooling of funds for a common purpose is alleged. [He] was apparently simply an agent for a number of separate and distinct principals, the plaintiffs being one such principal."[78]

Of course, any degree of control retained by an individual investor over the promoter's activities varies in direct proportion to the number of other participants in the enterprise. Where the number of other investors is substantial, the degree of control exercisable by one investor becomes attenuated and tends to approach zero. In this respect, the pooling of funds does tend to indicate the presence of a common enterprise. In other words, where investor funds are pooled, each individual investor's control is diminished to the extent other investors are present.[79] In *Milnarik,* however, due to the discretionary nature of the commodity accounts, the investors had no control over the investment.[80] It is obvious, therefore, that an allegation of pooling should have been immaterial to the court's inquiry.

The rationale of *Milnarick* has been rejected on numerous occasions.[81] For example, in *SEC v. Koscot Interplanetary, Inc.*,[82] the Commission sought injunctive relief on the basis that the defendants' "pyramid promotion enterprise" was a security and consequently should have been registered under the Securities Act of 1933.[83] Adopting the view of the Ninth Circuit, the court defined a common enterprise as "'one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties.'"[84] The court continued to emphasize that the key element in a determination of the existence of a common enterprise was "the uniformity of impact of the promoter's effort."[85] Applying the test less

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[78] *Id.* at 278, *quoting* Milnarik v. M-S Commodities, Inc., 320 F. Supp. 1149, 1151 (N.D. Ill. 1970). Other courts have applied the more stringent application of the commanality requirement reflected in *Milnarik. E.g.,* Stuckey v. duPont Glore Forgan, Inc., 59 F.R.D. 129, 131 (W.D. Cal. 1973); Wasnowic v. Chicago Bd. of Trade, 352 F. Supp. 1066, 1069 (M.D. Pa. 1972).

[79] *See, e.g.*, Jenson v. Continental Financial Corp., 404 F. Supp. 792, 800-04 (D. Minn. 1975).

[80] 457 F.2d at 276-78.

[81] *E.g.,* Rochkind v. Reynolds Sec., Inc., 388 F. Supp. 254, 257 (D. Md. 1975); Marshall v. Lamson Bros. & Co., 368 F. Supp. 486, 489 (S.D. Iowa 1974); Johnson v. Arthur Espey, Shearson, Hammill & Co., 341 F. Supp. 764, 765-66 (S.D.N.Y. 1972).

[82] 497 F.2d 473 (5th Cir. 1974).

[83] *Id.* at 474. For a thorough discussion of the "Koscot Scheme," see *id.* at 475-76.

[84] *Id.* at 478, *quoting* SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476, 482 n.7 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973).

[85] 497 F.2d at 478.

stringently than in *Milnarik*,[86] the court concluded that "the requisite commonality is evidenced by the fact that the fortunes of all investors are inextricably tied to the efficacy"[87] of the promoter. In the companion case of *SEC v. Continental Commodities Corp.*,[88] the *Koscot* court expressly rejected the *Milnarik* view[89] as well as the view that the "pro-rata sharing of profits is critical to a finding of commonality."[90]

It is suggested that the opinions in *Koscot* and *Continental* are more consistent with both the purposes of the securities laws and *Howey* than is *Milnarik*. In this light, it should be remembered that the Court in *Howey* placed little, if any, weight on the pooling concept amplified in *Milnarik*. Moreover, with respect to the investors, the *Howey* Court stated:

> A common enterprise managed by respondents or third parties with adequate personnel and equipment is therefore essential if the investors are to achieve their paramount aim of a return on their investments.[91]

Where only one investor and one promoter, rather than a series of independent investors, are involved in a financing scheme, the common enterprise question becomes even more enigmatic. In *Sunshine Kitchens v. Alanthus Corp.*,[92] the investor sought a tax shelter through the purchase of computers under an agreement which relegated the management of certain leasing arrangements to the promoter. The court, discussing *Koscot* and *Continental,* stated:

> By the reasoning of the two decisions, then, the common enterprise can be likened to a wheel, with investors as spokes and the promoter at the hub. The court was unconcerned that one spoke was not connected to any other spoke, but this does not mean that a common enterprise may exist with a hub and only one spoke as Sunshine would have the court find. Under such circumstances there is no common enterprise and the second prong of the *Howey* test is unsatisfied . . . .[93]

A similar result was reached in *Fargo Partners v. Dain Corp.*,[94] where the sole investor purchased an apartment from the seller with a managerial contract and leaseback arrangement accruing to the benefit of the seller.[95] Finding a common enterprise absent, the court stated that

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[86] *See id.* at 478 n.8.
[87] *Id.* at 479.
[88] 497 F.2d 516 (5th Cir. 1974).
[89] *Id.* at 521.
[90] *Id.* at 522.
[91] SEC v. W. J. Howey Co., 328 U.S. 293, 300 (1946).
[92] 403 F. Supp. 719 (S.D. Fla. 1975).
[93] *Id.* at 722.
[94] 405 F. Supp. 739 (D.N.D. 1975).
[95] *Id.* at 740-41.

> "[t]he [defendant] companies [were not] offering *something more than fee simple interests in land, something different from a farm or orchard coupled with management services.* They [were not] offering an opportunity to contribute money and to share in the profits of [an] . . . enterprise managed and partly owned by [the defendants]."[96]

This language, however, simply mirrors the facts as they existed in *Howey*. Moreover, the *Howey* test does not compel such a conclusion. Where a single investor's fortunes are otherwise dependent upon the success of the promoter's business operations, a common enterprise should exist regardless of whether the promoter is entitled to a direct share of the profits resulting from his own efforts.

C. Expectation of Profits

The *Howey* test requires an investment of money in the common enterprise which creates an expectation of profits as opposed to "a desire to use or consume the item purchased."[97] The concepts of a profit-seeking expectation and consumption are mutually exclusive. Typically, where the purchased item is to be consumed by the purchaser-investor, a security cannot exist under *Howey*.[98]

The distinction between an expectation of profit and consumption lies in the purchaser's right of control over the purchased item. Consumption exists where the purchaser has the right or motivation to control and exploit the purchased item. Futures contracts aptly illustrate this point. The fact that the contract is executory or that the investor was merely speculating and never intended to take delivery does not transform commodities futures into securities.[99] Where the discretion to invest in commodities lies with the broker, rather than the investor, it is not the commodity futures behind the arrangement which becomes securities, but rather the discretionary accounts themselves.[100]

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[96] *Id.* at 743, *quoting* SEC v. W. J. Howey Co., 328 U.S. 293, 299-300 (1946).

[97] United Hous. Foundation v. Forman, 421 U.S. 837, 852-53 (1975).

[98] *Id.*

[99] A commodity futures contract is simply an option to take delivery of a specified amount of a commodity at some future date. *See* Berman v. Dean Witter & Co., Inc., 353 F. Supp. 669, 671 (C.D. Cal. 1973) (Japanese yen futures). "Unless the investor reverses his position timely by selling what he has bought or buying what he has sold, he must accept delivery . . . ." McCurnin v. Kohlmeyer & Co., 340 F. Supp. 1338, 1341 (E.D. La. 1972) (cotton futures). Since the investor acquires the right to take absolute dominion and control over the commodity, whether he is merely speculating and never intends to take possession is completely immaterial. *See* Sinva, Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 253 F. Supp. 359, 367 (S.D.N.Y. 1966).

[100] In discretionary commodity accounts, complete control over investment decisions

In the context of a real estate transaction, consumption typically exists where the purchaser has the right or is motivated by the desire "to occupy the land or to develop it [himself]."[101] Upon transfer of the property by the seller, the purchaser takes charge and either develops the property for investment purposes or uses it to satisfy personal needs. In *Davis v. Rio Rancho Estates, Inc.*,[102] the promoter sold real estate through executory installment land contracts.[103] The court noted that, unlike *Howey,* the promoters entered into no collateral agreements concerning management of the development or distribution of the profits.[104] Holding that control of the property had passed to the investors, the court found that the promoters were interested merely "in recouping their investment, making a profit and moving on."[105] Thus, no federal cause of action existed.

The *Forman* decision constitutes a classic example of consumption. The literature presented to prospective purchasers emphasized several factors, including: (1) obtaining decent housing; (2) home ownership; and (3) a favorable environment for family and community living.[106] In short, the inducement held out to the purchasers was a chance to exploit an item they actually purchased as "subsidized low-cost living space."[107] The Court further buttressed its position that consumption

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is retained by the promoter. *See* Ramsey v. Arata, 406 F. Supp. 435, 438 (N.D. Tex. 1975). Since the discretionary account itself is the security, the fact that the investor could take possession of the underlying commodity is wholly immaterial. *See* Berman v. Orimex Trading, Inc., 291 F. Supp. 701, 702 (S.D.N.Y. 1968) (cocoa futures); Maheu v. Reynolds & Co., 282 F. Supp. 423, 426 (S.D.N.Y. 1968) (joint commodities account). *See also* SEC v. Continental Commodities Corp., 497 F.2d 516, 522 (5th Cir. 1974).

[101] SEC v. W. J. Howey Co., 328 U.S. 293, 300 (1946).

[102] 401 F. Supp. 1045 (S.D.N.Y. 1975).

[103] *Id.* at 1047. Plaintiff purchased a one-half acre plot of unimproved land in "Rio Rancho Estates," a residential subdivision near Albuquerque, New Mexico. The "Purchase Agreement" established a purchase price of $1,995 which was to be paid in monthly installments over a five-year period. Plaintiff's complaint alleged that the defendants' advertising and promotional materials "contained fraudulent material misrepresentations and omissions which induced [her] to purchase the property at an artificially inflated price." *Id.* (citation omitted).

[104] *Id.* at 1049-50.

[105] *Id.* at 1050; *accord,* United Sportfishers v. Buffo, 396 F. Supp. 310, 314 (S.D. Cal. 1975) (exchange of two parcels of land for two sportfishing vessels); Happy Inv. Group v. Lakeworld Property, Inc., 396 F. Supp. 175, 180-81 (N.D. Cal. 1975) (lots in recreational subdivision); Contract Buyers League v. F & F Inv., 300 F. Supp. 210, 224-25 (N.D. Ill. 1969) (sale of residential real estate). *But see* McCown v. Heidler, 527 F.2d 204, 208-11 (10th Cir. 1975) (undeveloped real estate coupled with specific developmental services pledged by promoter found to constitute security); Los Angeles Trust Deed & Mortgage Exch. v. SEC, 285 F.2d 162, 172 (9th Cir. 1960), *cert. denied,* 366 U.S. 919 (1961) (notes secured by deeds of trust coupled with skilled services held to be securities).

[106] United Hous. Foundation, Inc. v. Forman, 421 U.S. 827, 853-54 (1975).

[107] *Id.* at 851. It is generally agreed that the federal securities provisions are not an appropriate vehicle for consumer protection. *E.g.,* Bronstein v. Bronstein, 407 F. Supp.

was undeniably present by affirmatively demonstrating the lack of any profit expectation.[108] In this regard, the Court noted that with respect to invested funds, such an expectation may arise through capital appreciation or through a participation in earnings. A profit expectation in terms of capital appreciation was clearly absent since the purchasers of the apartments were required to offer them back to the defendant at the purchase price.[109] With respect to participation in earnings, the court of appeals had ascertained three separate grounds of profit expectation: (1) the deductibility for tax purposes of the monthly rental charge applied to interest on the mortgage; (2) the offering of an apartment at a cost below the rental charge for comparable housing; and (3) the possibility of income resulting from commercial facilities established for the convenience of apartment residents.[110] Examining each ground in step-by-step detail, the Supreme Court, however, disagreed with the panel's conclusions.

The Court properly pointed out that the deductibility of interest is simply a tax benefit available to any homeowner.[111] To equate a deduction which merely results in a reduction in taxable income with an expectation of profit is pure sophistry. Carried to its extreme, such logic leads to the conclusion that an expectation of profit is generated by a family's having additional children with a corresponding increase in dependency exemptions.[112]

The Court noted that the offering of an apartment at a cost below the rental charge for comparable housing was merely a state-supported financial subsidy. Because such welfare benefits cannot be liquidated into cash, they realistically had no connection with the production of profits.[113]

With respect to the possibility of income from commercial enterprises in the project, no evidence was found to indicate that the return from the operation of these enterprises exceeded the expenses incurred in providing the rental space.[114] Accordingly, the possibility of income

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925, 930 (E.D. Pa. 1976) ("The federal securities laws are designed to protect investors, not persons engaged in ordinary consumer or commercial loan transactions.") *See generally The Supreme Court, 1974 Term,* 89 HARV. L. REV. 254, 262 (1975).

[108] 421 U.S. at 842.

[109] *Id.*

[110] *Id.* at 846.

[111] *Id.* at 855.

[112] *Id. See also* Sunshine Kitchens v. Alanthus Corp., 403 F. Supp. 719 (S.D. Fla. 1975) (tax shelter investment in computers with leaseback agreement to promoter held not to result in expectation of profit).

[113] 421 U.S. at 855.

[114] *Id.* at 856.

from this source was rejected as "too speculative and insubstantial."[115] Moreover, since the literature provided to prospective purchasers did not mention the offset of rental costs against any income from the enterprise, none of the purchasers was found to be motivated by any expectation of profit from the enterprises.[116] The true purpose of these commercial enterprises, the Court pointed out, was not to produce profit for tenants, but to provide essential services to the residents thereby making the complex a more attractive housing facility.[117]

Prior to the Supreme Court's decision in *Forman,* the Second Circuit in *1050 Tenants Corp. v. Jakobson,*[118] on substantially the same facts, ruled that shares of stock in a cooperative housing corporation were securities.[119] In a substance-over-form analysis, the court's examination of the factual context in *Jakobson* revealed the presence of consumption since the defendant corporation "was formed and . . . operated to facilitate home ownership."[120] As in *Forman,* the purchasers in *Jakobson* were interested in acquiring living accommodations for personal use; however, an additional factor was present—the purchasers could realize capital appreciation on the sale of their stock. As pointed out by the Court in *Forman,* this additional factor can form the basis of a profit expectation among the purchasers.[121] Standing alone, however, potential capital appreciation is insufficient to recognize the presence of a security.[122] Instead, the fourth component of the *Howey* test requires the profit expectation, whether it be in respect of earnings or capital appreciation, to result solely from the efforts of others.[123]

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[115] *Id.*

[116] *Id.*

[117] *Id.* at 856-57.

[118] 503 F.2d 1375 (2d Cir. 1974). Plaintiff, 1050 Tenants Corporation, was sponsored and promoted by defendants as a cooperative housing corporation, formed pursuant to New York law. While a public offering of plaintiff's stock was made, the shareholder-tenant's rights and obligations did not flow from their stock ownership, but from a "uniform proprietary lease." *Id.* at 1377. In addition to the requirement that each shareholder-tenant execute such a lease, each was required "to make monthly payments to the corporation of his pro rata share of the expenses of the corporation." *Id.*

[119] *Id.* at 1378.

[120] *Id.* at 1377.

[121] United Hous. Foundation, Inc. v. Forman, 421 U.S. 837, 852 (1975).

[122] To conclude that the natural desire of any purchaser that his purchase should appreciate in value makes a "security" of what has been purchased, is obviously to so muddle the term as to make its meaningless.

Contract Buyers League v. F & F Inv., 300 F. Supp. 210, 224 (E.D. Ill. 1969) (purchase of personal residences).

[123] SEC v. W. J. Howey Co., 328 U.S. 293, 298 (1946).

D. *The Expectation of Profit Must Result Solely from the Efforts of Others*

Because each of the other three components are incorporated in it, the final component of *Howey* is perhaps the most difficult to analyze. Consideration of this component raises two obvious issues: (1) who are the "others" that are to provide the efforts; and (2) what "kinds" of efforts are they required to provide.

Initially, some confusion existed as to the scope of the "others" from whom the efforts must come. Such confusion, at least in part, was generated by the following dictum in *SEC v. C. M. Joiner Leasing Corp.*:[124] "The drilling of this well was not an unconnected or uncontrolled phenomenon to which salesmen pointed merely to show the possibilities of the offered leases."[125] Promoters, drawing upon this language, have argued that a security would not have existed if the wells in *Joiner* had been drilled by a third person not under the promoter's control.[126] Their position, however, has been successfully rebutted by the statement in *Howey* that the efforts may come from "the promoter or a third party."[127] Indeed, the reference to a "third party" has been held to overcome "any imputation that language in Joiner [was] meant to require [that] the collateral activity be that of the seller or one under his control."[128]

Where the promoter or third parties are agents of the purchaser, the latter is charged with the success of his investment and, by virtue of his right of control, no security can arise.[129] Furthermore, if the "others," representing the indiscernible general market, are not visible or readily ascertainable, the purchaser may not be relying upon others at all. Instead, the purchaser may be relying upon his own skills in forecasting future market performance. With respect to the purchase of an una-

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[124] 320 U.S. 344 (1943).

[125] *Id.* at 348.

[126] *See* Oil Lease Serv., Inc. v. Stephenson, 162 Cal. App. 2d 100, 327 P.2d 628 (1958) (although oil promotion structured to meet this criteria of *Joiner* a security was held to exist). *See also* Bloomenthal, *SEC Aspects of Oil and Gas Financing*, 7 Wyo. L.J. 49, 55 (1953).

[127] SEC v. W. J. Howey Co., 328 U.S. 293, 299 (1946).

[128] Roe v. United States, 287 F.2d 435, 439 n.5 (5th Cir. 1961). *See also* Continental Marketing Corp. v. SEC, 387 F.2d 466, 470 (10th Cir. 1967), *cert. denied*, 391 U.S. 905 (1968) (rejecting the contention that profits must come "solely from the efforts of the seller or a third person owned or controlled by the seller"); SEC v. Orange Grove Tracts, 210 F. Supp. 81, 83 (D. Mass. 1962) ("The fact that the third party may be legally distinct" from the seller does not place the transaction outside of *Howey*.).

[129] If the investor delegates performance to a third party over whom he holds a right of control, no security can exist despite the fact the investor ignores the daily operations of the enterprise. *See, e.g.*, Mr. Steak, Inc. v. River City Steak, Inc., 460 F.2d 666, 670 (10th Cir. 1972)(the existence of the power rather than its exercise is determinative).

dorned commodity, since there is no reliance on the efforts of the promoter or any third party, a mere speculative motive is insufficient to generate a security.[130] As indicated by Professor Loss, the same result arises in the purchase of real estate interests.

> The line is drawn, however, where neither the element of a common enterprise nor the element of reliance on the efforts of another is present. For example, no "investment contract" is involved when a person invests in real estate, with the hope perhaps of earning a profit as the result of a general increase in values concurrent with the development of the neighborhood, as long as he does not do so as part of an enterprise whereby it is expressly or impliedly understood that the property will be developed or operated by others.[131]

With regard to the purchaser-tenant's expectation of profit due to capital appreciation on resale of their stock, this is certainly analogous to the situation in *Jakobson.*[132]

When the "others" are readily visible and not under the control of the purchaser, the existence of a security may depend upon the "kinds" of efforts which the "others" are to provide. Similarly, consideration of the kinds of efforts the others are to provide raises again the issue of the kinds of labor the purchaser may invest.[133] The Supreme Court, providing some insight into its classification or denomination of efforts, explained in *Howey* that "[a] common enterprise *managed* by respondent or third parties . . . is . . . essential if the investors are to achieve . . . a return on their investments."[134] Later, the Court reviewed the presence of the essential elements of a profit-seeking business venture: "The investors provide the capital and share in the earnings and profits; the promoters *manage, control and operate* the enterprise."[135] In

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[130] [T]he purchase of commodities futures involves no reliance upon the efforts of promoters, managers, employees or any third party. The mere presence of a speculative motive on the part of the purchaser or seller does not evidence the existence of an "investment contract" within the meaning of the securities acts. In a sense anyone who buys or sells a horse or an automobile hopes to realize a profitable "investment." But the expected return is not contingent upon the continuing efforts of another.

Sinva, Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 253 F. Supp. 359, 369 (S.D.N.Y. 1966). Any profit from such an investment depends entirely upon the operation of the commodities market and the investors' market forecasting ability. McCurnin v. Kohlmeyer & Co., 340 F. Supp. 1338 (E.D. La. 1972), *aff'd,* 477 F.2d 113 (5th Cir. 1973) (cotton futures).

[131] 1 L. Loss, Securities Regulation 491-92 (2d ed. 1961).

[132] *See* note 118 and accompanying text *supra.*

[133] *See* note 50 and accompanying text *supra.*

[134] SEC v. W. J. Howey Co., 328 U.S. 293, 300 (1946) (emphasis added).

[135] *Id.* (emphasis added).

Forman, however, the Court stated that insofar as the *Howey* test is concerned,

> [t]he touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the *entrepreneurial or managerial* efforts of others.[136]

Thus, when read in light of *Forman, Howey* requires that the expectation of profit result "solely" from the entrepreneurial or managerial efforts of others. Consequently, subject to the limitations imposed upon the labor investment of the purchaser, where the efforts of others rise to the level of entrepreneurial or managerial contribution, a security may be found to exist.[137] The purchaser, however, may freely invest his labor provided it does not consist of entrepreneurial or managerial efforts. If it does, the existence of a security under *Howey,* with the *Forman* clarification, is precluded.

Characterization of the nature or quality of entrepreneurial or managerial efforts must be considered in light of the other components of the *Howey* test and the policy advanced by the federal securities acts. The common source underlying the components of this test lies in the control retained by the purchaser over the potential success of his investment. In this respect, the presence of a common enterprise and the distinction between profit expectation and consumption are both predicated upon investor control. Where the promoter is merely an agent of the investor, with the latter retaining control, no common enterprise will exist. Furthermore, if the purchaser takes possession of and personally exploits his investment, consumption rather than a profit-seeking motive arises. In fact, one of the criteria developed in the *Howey* opinion for determining the presence of a profit-seeking business was whether the investor controlled the enterprise.

Characterizing entrepreneurial or managerial efforts as those affording control over the success of the investment is also consistent with the purposes of the federal securities acts—full and fair disclosure and the prevention of fraud. Where the investor is in control, *e.g.,* a general partnership interest, he may typically lose the right to disclosure of all relevant information affecting the success of the enterprise.[138] Corre-

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[136] United Hous. Foundation v. Forman, 421 U.S. 837, 852 (1975) (emphasis added).

[137] An assignment of leasehold interests in exchange for cancellation of indebtedness does not involve entrepreneurial or managerial efforts of others, but merely a duty to pay money in respect of the leases. *See* First Nat'l Bank v. Western Financial, Inc., 403 F. Supp. 701 (D. Minn. 1975). Similarly, a mere sale of real estate is a commercial transaction which does not involve the managerial efforts of others. United Sportfishers v. Buffo, 396 F. Supp. 310, 314 (S.D. Cal. 1975).

[138] *See, e.g.,* Hirsh v. duPont, 396 F. Supp. 1214 (S.D.N.Y. 1975).

> [W]here the investor obtains managerial control and thereby gains access to

spondingly, the investor's right of control and access to information places him in a much more favorable position to determine whether he has been defrauded in the first instance. From such a perspective, he has a superior opportunity to minimize his losses and quickly recoup any loss occasioned by his earlier failure to detect the fraud. The concept of control, in addition to being consistent with all components of *Howey* and promoting policy considerations, also tends to promote certainty in securities transactions by initially permitting the parties to evaluate more effectively their respective rights and obligations. Accordingly, entrepreneurial or managerial efforts should be classified as those efforts which afford a degree of control over the success of the investment.[139]

Where classification is couched in terms of control, a security will exist where the controlling efforts are generated solely by the promoter or identifiable third parties rather than by the investor.[140] As previously noted, the sale of land technically is not classified as a security simply because the purchaser expects the property to appreciate in value.[141] If in connection with that sale, however, parties other than the investor are to provide controlling managerial efforts which generate the profit, whether it be participation in earnings or capital appreciation, a security may exist despite the fact that land is also involved. In *Howey,* the promoters as well as all investors participated in the earnings generated by the promoters' operation of the enterprise.[142] In contrast, *McCown v. Heidler*[143] involved profit expectation in the form of capital appreciation resulting from the promoter's managerial efforts.[144] The plaintiff-investors purchased lots in Timberlake, a large real estate development. In attempting to determine the appropriateness of the defendant's motion for summary judgment, the Tenth Circuit accepted as true the following allegations by the investors:

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information about the issuer, he has less need of the protection of the fraud and disclosure provisions of the securities laws.

Id. at 1224.

[139] Several courts have considered the investor-control element as the critical index in gauging the existence of a security. *E.g.,* Nash & Assocs., Inc. v. Lum's of Ohio, Inc., 484 F.2d 392, 395 (6th Cir. 1973)(no security existed where franchisee merely invested in and controlled his own business); Mr. Steak, Inc. v. River City Steak, Inc., 460 F.2d 666, 669-70 (10th Cir. 1972)(no security where investor held independent right to control success or failure of restaurant franchise); Beefy Trail, Inc. v. Beefy Kind Int'l, Inc., 348 F. Supp. 799, 805-06 (M.D. Fla. 1972)(same). *See also* Long, *supra* note 48, at 176.

[140] *See* SEC v. W. J. Howey Co., 328 U.S. 293, 300 (1946).

[141] See note 131 and accompanying text *supra.*

[142] SEC v. W. J. Howey Co., 328 U.S. 293, 295-96 (1946). *See also* Los Angeles Trust Deed & Mortgage Exch. v. SEC, 285 F.2d 162 (9th Cir. 1960), *cert. denied,* 366 U.S. 919 (1961).

[143] 527 F.2d 204 (10th Cir. 1975).

[144] *See id.* at 211.

> "The offer and sale of lots in the Timberlake Development was not only the offer and sale of subdivision lots in a real estate development, but the sale of a contractual promise by Heidler Corporation to improve the project, including the construction of a country club, an 18-hole championship golf course, stables, equestrian center, tennis courts, clubhouses and swimming pools. The lot purchasers had no control over, or participation in the improvement of the project, but entrusted their monies solely to the management of Heidler Corporation. The lots, absent fulfillment of Heidler Corporation's promises to improve them, had little or no value. Substantial purchase prices were paid for the promised improvements. The lots were purchased in expectation that fulfillment of the promise to improve them by Heidler Corporation would result in a substantial increase in the value of the lots. The lots were sold as, and purchased for, investment."[145]

Without the promised improvements, the value of the lots would have been inconsistent with the price paid by the investors.[146] Concededly, some investors could have purchased the lots as investments rather than building sites and thus relied solely upon the promoter's controlling efforts for capital appreciation and their expectation of profit. Therefore, the court concluded, a factual issue was raised as to the existence of a security.[147]

If the promoters in *McCown* had couched their sales literature and contractual arrangements in general terms rather than spelling out the specific, concrete services to be provided, the existence of a security arguably could have been avoided. In *Happy Investment Group v. Lakeworld Property, Inc.*,[148] the purchasers of lots in a recreational subdivision contended that their profit expectation was based solely upon the promoters' prospective land development efforts.[149] Characterizing the

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[145] *Id.* at 209.

[146] *Id.* at 211; *see* Continental Marketing Corp. v. SEC, 387 F.2d 466, 470-71 (10th Cir.), *cert. denied*, 391 U.S. 905 (1968).

[147] 527 F.2d at 211. In *Forman*, the Court emphasized that in some transactions an investor may be offered either a commodity or real estate for the dual purposes of use and profit expectation. United Hous. Foundation, Inc. v. Forman, 421 U.S. 837, 853 n.7 (1975) (dictum). The *McCown* court apparently subscribes to the notion that a dual motivation of consumption and profit expectation does not preclude the existence of a security. *See* 527 F.2d at 211. Considering that the criteria for gauging the existence of a security are the terms of the offer in light of the investor's reasonable expectations of profit, *see* notes 39 through 42 and accompanying text *supra*, a bifurcation of the *McCown* transaction to hold that *some* investors purchased a security would be inappropriate.

[148] 396 F. Supp. 175 (N.D. Cal. 1975).

[149] Plaintiffs . . . received the *Alta Sierra Sentinel*, a news bulletin which contained glowing reports of home building, community activities, and of the general progress of the subdivision [in which plaintiffs had invested]. There was, according to various handouts prepared by Lakeworld, an Architectural Control Committee, formed to "protect the investment of property owners in [the subdivision]."

promoters as "masters of generalizations,"[150] the court concluded that

> although the literature and sales pitch by defendants might lead plaintiffs to believe that defendants would give them more than land, *in fact* defendants never offered specialized or particularized skills . . . .[151]

Although the promoters may have subjectively created an illusion that managerial efforts were involved, from a practical point of view they had in fact "offered to do and did nothing more than sell plaintiffs a parcel of land."[152] Consequently, the land sales in question did not constitute investment contracts subject to the federal securities laws.

Although the facts in *Davis v. Rio Rancho Estates, Inc.*[153] were substantially the same as those in *McCown,* a contrary result obtained. The plaintiff in *Davis* alleged that certain land he purchased from the defendant was offered and purchased only as an investment with the expectation that it would appreciate in value through the efforts of the promoters.[154] The court posited that even if the promoters had agreed to build "roads and other improvements," these were not the kinds of managerial efforts contemplated by *Howey* since there was no "promise to run the development and distribute profits."[155] In contrast with *McCown,* the *Davis* court failed to recognize that a finding of the requisite managerial efforts does not necessarily require a distribution of profits by the promoters. Instead, capital appreciation will suffice if it results solely from the efforts of others.[156] Though the analysis in *Davis* may be suspect, it is nevertheless possible that the court reached the correct result. The promoters in *McCown* offered an entire community developmental package which included services beyond the mere building of roads and other improvements typically associated with real estate promotion. The offering of these additional facilities may have tipped the jurisdictional scales.

If the efforts, which the purchaser has a right to invest, produce an actual right of control, the existence of a security is precluded. In such cases, the crucial distinction is whether the investor is actually empowered to affect the success of the enterprise.[157] Economic feasibility and

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Id. at 179 (citation omitted).

[150] *Id.* at 180.

[151] *Id.*

[152] *Id.* at 181.

[153] 401 F. Supp. 1045 (S.D.N.Y. 1975).

[154] *Id.* at 1049. Plaintiffs had purchased vacant lots in New Mexico. *Id.* at 1050. Defendant's advertising materials represented that land values in the area were increasing and that the purchasers could expect a substantial increase in the value of their property within the next several years. *Id.* at 1049 (citation omitted).

[155] *Id.* at 1050.

[156] *See* McCown v. Heidler, 527 F.2d 204 (10th Cir. 1975).

[157] *See* note 138 and accompanying text *supra.*

investor expertise are factors to be considered in determining whether such power or right of control is real or illusory. In *Continental Marketing Corp. v. SEC*,[158] both economic feasibility and investor expertise were present. The promoter in *Continental* offered contracts for the sale, care and management of live beavers for breeding purposes.[159] After purchase, the investor had the option to

> care for his own animals with each pair of beaver requiring a private swimming pool, patio, den and nesting box together with the services of a veterinarian, dental technician, breeding specialist, etc. or . . . to place his animals (at a cost of $6 per month per animal) with a professional rancher who [was] a member of the defendant North American Beaver Association which in turn [had] available the technical assistance of two ranchers' service companies . . . .[160]

Because they lacked the necessary facilities and expertise, the investors invariably chose to contract with the ranchers rather than take possession of the animals.[161] Since the investors had only an illusory and no actual right of control over the success of their investment, the court properly found the presence of a security.[162]

In gauging the existence of a right of control, the focus is on the quality rather than the quantity of investor participation.[163] The magnitude of an investor's work contribution is not the appropriate criterion.[164] For example, if the investor is merely an employee of an enterprise controlled and directed by the promoter, the success of the enterprise is dictated by the promoter, despite the investor's efforts.[165] Instead, the controlling determination is whether the investor has a right of control over his investment by virtue of the efforts which he may contribute. For

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[158] 387 F.2d 466 (10th Cir. 1967), *cert. denied*, 391 U.S. 905 (1968).

[159] 387 F.2d at 468.

[160] *Id.* at 468-69.

[161] *Id.* at 469.

[162] *Id.* at 471; *accord,* Glen-Arden Commodities, Inc. v. Costantino, 493 F.2d 1027 (2d Cir. 1974)(sale of scotch whiskey receipts to buyers without proper storage facilities or expertise to select whiskey).

[163] *See* note 139 and accompanying text *supra. See also* Ramsey v. Arata, 406 F. Supp. 435 (N.D. Tex. 1975).

[164] When the investor merely performs nominal services or physical labor, no access to information about the issuer is afforded and the need for protection of the securities provisions clearly exists. *See* note 138 *supra. Compare* Nash & Assocs., Inc. v. Lum's of Ohio, Inc., 484 F.2d 392 (6th Cir. 1973)(focusing upon the control held by the investor) *with* Lino v. City Investing Co., 487 F.2d 689 (3d Cir. 1973)(finding absence of a secuirty after examining quantity of the "very real work" required of investor).

[165] Since employees providing non-controlling physical efforts do not otherwise have access to information normally provided by the registration statement, they are unable "to fend for themselves," SEC v. Ralston Purina Co., 346 U.S. 119, 125 (1952), and should be protected by the federal securities provisions.

example, in *Chapman v. Rudd Paint & Varnish Co.*,[166] the promoter-defendant sold an exclusive distributorship for the sale of a product designed to prevent runs in nylon hosiery.[167] In addition to charging the investor with the duty to sell and distribute the product in a specified area, the distributorship agreement stated that

> the distributor [investor] "understands and agrees that the success of this DISTRIBUTORSHIP is directly related to the efforts of DISTRIBUTOR and therefore no guarantees of sales profits or volume can be made."[168]

Noting that the success of the enterprise was expressly dependent upon the investor's efforts and that he had "vigorously commenced operations" after the agreement was finalized, the court concluded that no security was involved.[169]

When read in connection with *Forman*, *Howey* clearly requires that the expectation of profit result solely from the controlling entrepreneurial or managerial efforts of others. A final question, however, merits particular attention: In light of the *Forman* clarification, is there a need for further refinement or an outright alternative to the *Howey* test?

IV. Proposed Alternatives to *Howey*

A. "Managerial Efforts" Test

Prior to *Forman*, a number of alternatives to *Howey* had been proposed. In *SEC v. Glenn W. Turner Enterprises, Inc.*,[170] the Ninth Circuit acknowledged the basic premise that because *Howey* required the expectation of profit to come "solely" from the efforts of others, *any* degree of purchaser involvement or effort would preclude the existence of a security.[171] However, in view of the apparent mechanical inflexibility of *Howey*, the court deemed it necessary to modify the "solely from the efforts of others" prerequisite and promulgated the so-called "managerial efforts" test.

> [W]e adopt a more realistic test, whether the efforts made by those other than the investor are the undeniably significant ones, *those essen-*

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[166] 409 F.2d 635 (9th Cir. 1969).

[167] *Id.* at 638.

[168] *Id.* at 640.

[169] *Id.*; *accord*, Mr. Steak, Inc. v. River City Steak, Inc., 460 F.2d 666, 670 (10th Cir. 1972).

[170] 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973).

[171] 474 F.2d at 481, 482.

> *tial managerial efforts which affect the failure or success of the enterprise.*[172]

In *Turner*, purchasers of self-improvement courses invested their money and individual efforts in a pyramid franchise scheme by inducing prospects to attend meetings conducted by the promoters.[173] Under this scheme, characterized by the court as a "gigantic and successful fraud,"[174] sales would theoretically expand forever. In practice, of course, sales were limited by market saturation. Consequently, early investors were likely to reap substantial profits at the expense of those who invested nearer the saturation point. To realize *any* profits, a purchaser was required to identify prospects and persuade them to attend promotional meetings. To lure other prospective purchasers, the purchaser was

> told to "fake it 'til you make it," or to give the impression of wealth even if it [had] not been attained. He [was] urged to go into debt if necessary to purchase a new and expensive automobile and flashy clothes, and to carry with him large sums of money, borrowing if necessary, so that it [could] be ostentatiously displayed.[175]

If he failed to induce others to attend the promotional meetings and eventually invest in the scheme, the purchaser did not profit.

In testing the presence of a security, the *Turner* court apparently focused upon the quality of investor participation in the scheme.[176] It noted that while the *Howey* test could easily be evaded by requiring the purchaser to "contribute a modicum of efforts," the challenged scheme should be no less of a security as a result of such a contribution.[177] On this premise, the court effectively modified the *Howey* test

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[172] *Id.* at 482 (emphasis added). In outlining this alternative test, the court noted that

> in light of the remedial nature of the [securities] legislation, the statutory policy of affording broad protection to the public, and the Supreme Court's admonitions that the definition of securities should be a flexible one, the word "solely" [in the fourth component of the *Howey* test] should not be read as a strict or literal limitation on the definition of an investment contract . . . .

Id.

[173] *Id.* at 478, 479.

[174] *Id.* at 478.

[175] *Id.* at 480.

[176] *See* Ramsey v. Arata, 406 F. Supp. 435, 438 (N.D. Tex. 1975)("The refinements of *Howey* contained in *Glen Turner [sic]* . . . compel this Court to analyze the complaint in terms of the quality of the investor/plaintiff's contribution to the investment scheme . . . .").

[177] 474 F.2d at 482. The SEC has made a similar statement:

> It must be emphasized that the assignment of nominal or limited responsibilities to the participant does not negative the existence of an investment contract; where the duties assigned are so narrowly circumscribed as to involve

by holding that an investment of effort by a purchaser would not preclude the finding of a security, provided the purchaser does not contribute "essential managerial efforts."[178] Although the court failed to delineate what in its view constitutes "essential managerial efforts," it is apparent that its primary focus on the quality rather than the quantity of investor participation was correct.[179] Indeed, such an approach not only is consistent with the remaining components of *Howey* but finds support in the underlying policy of the federal acts.[180]

While most recent cases citing *Turner* have not required strict application of the managerial efforts test,[181] the same result can be obtained simply by examining the nonphysical control-type efforts which *Howey* and *Forman* now contemplate. The most difficult situation in applying a control analysis arises when an investor holds some right of control but predominate control over the success of the investment is retained by the promoter or third parties. Only if the phrase "essential managerial efforts" is defined in terms of predominant controlling efforts does *Turner* reach this specific situation.

In *Hirsch v. duPont,*[182] two investors purchased interests in a general partnership and became members of the eight-member senior policy-making committee.[183] Although predominant control over the

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> little real choice of action or where the duties assigned would in any event have little direct effect upon receipt by the participant of the benefits promised by the promoter, a security may be found to exist.

Securities Act Release No. 5211 (Nov. 30, 1971), *reported in* C.C.H. Fed. Sec. L. Rep. ¶ 78446 (1971-72).

[178] 474 F.2d at 482. *See generally* SEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974); Nash & Assocs., Inc. v. Lum's of Ohio, Inc., 484 F.2d 392 (6th Cir. 1973).

[179] *See, e.g.,* Lino v. City Investing Co., 487 F.2d 689, 692-93 (3d Cir. 1973).

[180] *See* notes 136, 138 & 139 and accompanying text *supra.* Since the *Forman* Court was not confronted with a factual situation requiring consideration of the *Turner* approach, it properly refused to express any opinion regarding its validity.

> Although the issue is not presented in this case, we note that the Court of Appeals for the Ninth Circuit has held that "the word 'solely' should not be read as a strict or literal limitation on the definition of an investment contract, but rather must be construed realistically, so as to include within the definition those schemes which involve in substance, if not form, securities." . . . We express no view, however, as to the holding of this case.

United Hous. Foundation v. Forman, 421 U.S. 837, 852 n.16 (1975) (citation omitted). *But see* Comment, *Recreational Land Subdivisions as Securities,* 13 HOUS. L. REV. 153, 162-63 (1975)(arguing that *Forman* implicitly accepted the *Turner* rationale).

[181] *See* note 139 *supra. See generally* Bronstein v. Bronstein, 407 F. Supp. 925, 929 (E.D. Pa. 1976)(applicability of "solely from efforts of others" component of *Howey* is "debatable"). Other courts have distinguished the pyramid sales scheme in *Turner* from other financial techniques. *E.g.,* Plum Tree, Inc. v. Seligson, 383 F. Supp. 307, 309 (E.D. Pa. 1974).

[182] 396 F. Supp. 1214 (S.D.N.Y. 1975).

[183] *Id.* at 1225.

operation of the partnership was retained by "others," the court concluded that the right of control which passed to the investors was sufficient to preclude, as to their interests, the existence of a security.[184] While there is authority to the contrary,[185] in any situation where, by virtue of his right of control, the investor is otherwise entitled to disclosure of information about the enterprise, it is submitted that no security should be held to exist. In these instances, the policies underlying the federal acts have been effectuated, and there is no need for duplicitous disclosure through the filing of a registration statement. Where the investor does have a degree of actual, though not predominant, right of control but no informational access, a more flexible approach may be necessary.[186] Such an approach, however, must be implemented with caution since the result could generate confusion and uncertainty in securities transactions, ultimately causing needless registration at an increased cost to both investors and consumers.

B. The "Risk Capital" Approach

In *Silver Hills Country Club v. Sobieski,*[187] petitioners had devised a membership plan intended to finance certain improvements in a new

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[184] *Id. See also* Long, *Commodity Options—Revisited,* 25 DRAKE L. REV. 75, 93 n.74 (1975) (applying similar analysis to a hypothetical partnership consisting of hundreds of general partners).

[185] *See* note 147 *supra.*

[186] This apparently was the situation in *Turner, i.e.* the investors, by inducing others to attend promotional meetings, did have some control over the expectation of profit, yet predominant control over the promotional meetings leading to the culmination of a sale was retained by the promoter. *See* notes 173 through 175 and accompanying text *supra.* While there is no indication that the investors had a right to full disclosure of all relevant information affecting the success of their investment, they were able to discern that their active participation in the fraudulent promotion was necessary to realize a profit. *See* note 175 and accompanying text *supra.* Perhaps the very purchasers who filed suit either participated or would have done so but for the degree of market saturation. Instead of seeking to prevent fraud, *Turner* raises the possible anomaly of protecting purchasers who either participated in fraud or intended to do so. A similar difficulty is raised by SEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974), where, in order to induce prospects to attend meetings, investors were told to use the curiosity approach: "[T]ell him you've seen a money tree and would like for him to take a look at it." *Id.* at 476. Moreover, the investors in *Koscot* were required to actively participate in the fraudulent promotional meetings.

These cases not only raise the possible spectre of the defenses of unclean hands and in pari delicto, but also indicate the difficulties which may arise where jurisdiction is found to exist when the investor retains less than a predominant right to control the success of his investment. *See* James v. DeBreuil, 500 F.2d 155, 158 (5th Cir. 1974)(indicating the availability of these defenses in federal security matters).

[187] 361 P.2d 906 (Cal. 1961)(en banc), *noted in* 50 CALIF. L. REV. 156 (1962); 14 HASTINGS L. REV. 181 (1962).

country club. In addition to purchasing a membership for as much as $250, each investor was required to pay monthly dues in an amount established at the time of the membership purchase. While each purchaser received the normal benefits accompanying membership in a country club, he or she derived no expectation of profit either from capital appreciation or participation in earnings.[188] On these facts alone, a security clearly could not exist under *Howey;* however, the California Supreme Court, interpreting an obscure provision of the state securities act,[189] articulated the "risk capital" concept.

> Since the [California] act does not make profit to the supplier of capital the test of what is a security, it seems . . . that its objective is to afford those who risk their capital at least a fair chance of realizing their objectives in legitimate ventures whether or not they expect a return on their capital in one form or another.[190]

The court concluded that the state securities provision was "as clearly applicable to the sale of promotional memberships . . . as it would be had the purchasers expected their return in some such familiar form as dividends."[191]

Despite a subsequent, expansive interpretation of *Silver Hills* by the California Attorney General,[192] the risk capital concept has not been expressly adopted by any federal court. Indeed, the doctrine has been specifically rejected by at least one circuit court of appeals[193] and arguably by the Supreme Court in *Forman.* In *Forman,* any dissatisfied pur-

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[188] 361 P.2d at 907.

[189] At the time of the hearing, the Californian Corporations Code defined a security as

> (a) Any stock, including treasury stock; any certificate of interest or participation; any certificate of interest in a profit sharing agreement; any certificate of interest in an oil, gas, or mining title or lease; any transferable share, investment contract, or beneficial interest in title to property, profits, or earnings.
>
> (b) Any bond; any debenture; any collateral trust certificate; any note; any evidence of indebtedness, whether interest bearing or not.
>
> (c) Any guarantee of a security.
>
> (d) Any certificate of deposit for a security.

CAL. CORP. CODE. § 25008 (West 1955).

[190] 361 P.2d at 908-09.

[191] *Id.* at 909.

[192] Following *Silver Hills,* the Attorney General of California indicated that "whenever an initially undercapitalized franchisor relie[d] upon franchise fees to raise his initial capital," a security was involved. Bitter v. Hoby's Int'l, Inc., 498 F.2d 183, 185 (9th Cir. 1974), *citing* 49 Ops. Cal. Atty. Gen. 124 (1967).

[193] Bitter v. Hoby's Int'l, Inc., 498 F.2d 183, 185 (9th Cir. 1974). Another court has suggested that the "risk capital" theory be limited "to situations where exceptionally high risk, speculative franchises are involved." Mr. Steak v. River City Steak, 324 F. Supp. 640, 647 (D. Colo. 1970), *aff'd,* 460 F.2d 666 (10th Cir. 1972).

chaser of a Co-op City apartment was entitled to recover his entire investment.[194] Since no risk of capital loss was assumed by the purchaser, the Court reasoned that "[e]ven if we were inclined to adopt . . . a 'risk capital' approach, we would not apply it in the present case."[195] Despite this overture, the *Forman* prerequisite of an *expectation of profit* evidences an implicit rejection of the result in *Silver Hills* and perhaps a rejection of the risk capital concept itself.

As an alternative to express adoption of the risk capital approach, the SEC has suggested that this concept be superimposed upon the federal securities provisions through the "instrument commonly known as a security" phrase found in both the 1933 and 1934 Acts.[196] This approach would recognize state law as a relevant factor in determining what is "commonly known as a security": If the risk capital concept is applied to determine the existence of a security under state law, a similar application would be appropriate in the federal context. Despite SEC promotion, this argument also appears to have been implicitly rejected by the *Forman* Court's refusal to isolate the "investment contract" and "instrument commonly known as a security" provisions of the federal acts.[197] Instead, the Court chose to apply the basic *Howey* test to define both terms.[198]

C. *The Hawaii Market Center Test*

In *State v. Hawaii Market Center, Inc.*,[199] the Hawaii Supreme Court effectively combined the risk capital approach and a modified version of the *Howey* test to delineate a four-component formula to govern the determination of whether a security exists. Recognizing that the "primary weakness of the *Howey* formula is that it has led courts to analyze investment projects mechanically,"[200] the court held that an investment contract is created whenever

> (1) [an] offeree furnishes initial value to an offeror, and
> (2) a portion of this initial value is subjected to the risks of the enterprise, and
> (3) the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial

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[194] United Hous. Foundation, Inc. v. Forman, 421 U.S. 837, 857 n.24 (1975).

[195] *Id.* at 857 n.23.

[196] *See* SEC v. Koscot Interplanetary, Inc., 365 F. Supp. 588, 592 (N.D. Ga. 1973), *rev'd*, 497 F.2d 473 (5th Cir. 1974).

[197] 421 U.S. at 852.

[198] *Id.*

[199] 485 P.2d 105 (Haw. 1971).

[200] *Id.* at 108.

value; will accrue to the offeree as a result of the operation of the enterprise, and

(4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.[201]

Such a formula, the court concluded, would "protect the public from the novel as well as the conventional forms of financing enterprises."[202]

While the type of analysis advocated in *Hawaii Market Center* has some support among the commentators,[203] by requiring only "a valuable benefit of some kind" rather than a profit expectation, the third element of the test stands in stark conflict with *Howey*. In *Forman,* the tax deduction of interest on the mortgage, the rental of an apartment at below market cost and the possibility of income from commerical facilities could collectively or individually rise to the level of a "valuable benefit."[204] The Court, however, held that the presence of such benefits could not be equated with an expectation of profit.[205] In light of the expectation-of-profit component of *Howey,* the Court appropriately should not consider the *Hawaii Market Center* test compatible with the federal definition of a security.

In both *Hawaii Market Center* and *Silver Hills,* the courts drew in part upon the risk capital approach. In defining a security under the federal provisions, however, reliance on this concept indicates a misunderstanding of the conflicting policies of the state and federal securities provisions. The risk capital test focuses upon capitalization, *i.e.* the value of the assets underlying the investment enterprise,[206] and requires an analysis of the merit of the investment. While merit considerations are embodied within the policy of several *state* securities acts, they play no role in the policy of the *federal* provisions.[207] If a doctrinal shift in the federal policy is required, it should be generated by Congress rather than the judiciary.

V. Conclusion

During the last forty years, the concept of exactly what constitutes a "security" has expanded and contracted with the introduction of new and more novel investment schemes into the realm of financial activities. To effectuate the policies of full and fair disclosure of relevant

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[201] *Id.* at 109.

[202] *Id.*

[203] *E.g.*, Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 W. Res. L. Rev. 367, 377 (1967).

[204] United Hous. Foundation, Inc. v. Forman, 421 U.S. 837, 855-57 (1975).

[205] *Id.* at 857.

[206] Long, *supra* note 48, at 167-70.

[207] *See* note 10 and accompanying text *supra*.

information and the prevention of fraud, the courts have flexibly construed the securities concept through a substantive application of the securities provisions. Shunning a mechanical approach, the courts now analyze the economic realities of each individual transaction to determine whether it is contemplated by the spirit, as well as the literal definition of a "security." Through the classical *Howey* approach, investments once thought to fall beyond the securities provisions have been absorbed into the securities categorization, often to the amazement of newcomers to the securities bar.

A qualitative rather than a quantitative analysis of investor participation is the key to substantively gauging the existence of a security. Where such an analysis reveals that the investor has a right to control the success of his investment, a security from a substantive point of view should not exist. By directing the focus to quality, greater investment certainty is created than if some theoretical, perhaps whimsical, acceptable level of investor participation were deemed the appropriate criterion. Such certainty will generate increased stability in planning investment offerings at an ultimately reduced cost to all concerned.

In addition, a control analysis more properly comports with the necessity of affording protection to naive or unsophisticated investors. Corporate personnel in a position to control their investments and to acquire relevant financial and investment information because of their involvement in corporate activities arguably can invest without statutory protection. The ability to control the success of one's investment thus negatives the finding of a security. Where, however, the investor has no actual right of control over the success of his investment, he truly is in need of full disclosure and protection against fraudulent schemes.

Despite recent criticism of the basic *Howey* test, any alternative proposals for determining the presence of a security must be consistent with underlying federal policy. Courts have found it necessary to extend that policy into areas not originally contemplated in order to protect investors from the more novel and fraudulent investment schemes. Such an extension, however, in the interest of stability, should be implemented after due deliberation by Congress rather than through the piecemeal adoption of a judicial alternative.

PROBLEMS OF VALUATION AND EQUALIZATION IN MISSISSIPPI'S AD VALOREM TAX SYSTEM

*James L. Robertson**

It has been documented common knowledge for more than a decade that severe inequity is prevalent in the system of ad valorem property taxation in Mississippi.[1] Faced with inadequate budgets, lack of trained personnel and a variety of political pressures, Mississippi's eighty-two tax assessors[2]—all elected public officials[3] with few qualifications other than that they be registered voters in the county[4]—have simply been unable to perform the highly complex and technical tasks incumbent upon persons holding such a position. The commands of Mississippi's constitution[5] and the dictates of its statutes[6] are regularly ignored on the

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*B.A. 1962, University of Mississippi; J.D. 1965, Harvard University; Partner, Campbell & DeLong, Greenville, Mississippi. The author gratefully acknowledges the assistance of H. Dixon Montague, Articles Editor, *Mississippi Law Journal,* in the preparation of this article.

[1] D. McKinney & P. Lowry, Mississippi Assessment—Sales Ratio Study, 1962 (1964); W. Newhouse, Constitutional Uniformity and Equality in State Taxation 248-53 (1959); Mississippi Economic Council, County Assessment Practices (1971); Mississippi Economic Council, County Property Reappraisals: An Analysis of the Experience of Five Mississippi Counties (1968); Mississippi Economic Council, County Assessment Procedures: Case Studies of Two Mississippi Counties (1964); Mississippi Economic Council, Modernizing County Assessments (1960); U.S. Bureau of the Census, Dep't of Commerce, Property Values Subject to Local General Property Taxation in the United States: 1975 59-61 (1976).

The lack of uniformity and inequity which is present in the valuation and the assessment of real property in Mississippi is clearly indicated in Appendices I and II *infra.*

[2] The office of county tax assessor is a constitutionally created position. *See* Miss. Const. art. 5, § 135.

[3] Miss. Code Ann. § 23-5-93 (1972) (county tax assessor shall be elected every four years).

[4] Miss. Const. art. 12, § 250 provides that "[a]ll qualified electors and no others shall be eligible to [hold public] office, except as otherwise provided in this Constitution." In the absence of any additional constitutional or statutory qualifications, the office of county tax assessor is open to almost any adult Mississippi resident. The complexity of the tasks performed by the assessor, however, necessitate that a more qualified person occupy the position. *See* section V. *infra.*

[5] Miss. Const. art. 4, § 112 states:

> Taxation shall be uniform and equal throughout the state. Property shall be taxed in proportion to its value. Property shall be assessed for taxes under general laws, and by uniform rules, and in proportion to its value.

[6] Miss. Code Ann. § 27-35-49 (1972) and *id.* § 27-1-19 provide respectively that "[i]t shall be the duty of the tax assessor to assess all the lands in his county . . . according to

ground that compliance is not feasible. If reason and logic are to have any place in the state's ad valorem taxation system, economic laws must surely be given primary consideration. Yet, Mississippi's counties have consistently ignored generally accepted economic principles, inevitably yielding an illogical and inequitable property taxation system.

The inadequacies and inequities present in the ad valorem taxation system in Mississippi are by no means unique. Other states have encountered similar difficulties, repeatedly evidenced by tax equalization litigation in their courts.[7] The result of this litigation has been substantially consistent: constitutional and statutory commands must either be repealed, amended or obeyed.[8] For better or for worse, Mississippi's turn is coming.

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its true value . . ." and that

> [t]he county assessor shall from time to time by personal inspection and examination . . . gather and record . . . any and all available data and information bearing upon the location, number, amount, kind, and value of any and all property . . . which he is required by law to assess.

[7] *E.g.*, Weissinger v. Boswell, 330 F. Supp. 615, 623-24 (M.D. Ala. 1971) (per curiam) (Alabama ad valorem tax system held violative of state's uniformity and equality clause as well as the equal protection clause of the fourteenth amendment); Lanier v. Walt Disney World Co., 316 So. 2d 59, 62 (Fla. Dist. Ct. App. 1975) (violative of state constitution to assess real property for taxation at more or less than fair market value); Russman v. Luckett, 391 S.W.2d 694, 696, 700 (Ky. Ct. App. 1965) (land must be valued at market value for property taxation purposes or valuation will be violative of the state uniformity and equality clause); Bettigole v. Assessors of Springfield, 178 N.E.2d 10, 15 (Mass. 1961) (practice of assessing different parcels of real property at different percentages of market value held violative of state constitution); Smith v. Davis, 426 S.W.2d 827, 834 (Tex. 1968) (property taxation scheme must be applied equally and uniformly or it will be held invalid); Perkins v. County of Albermarle, 214 Va. 240, 198 S.E.2d 626, 628 (1973) (method used by county to assess property violated uniformity clause of state constitution). *See generally* W. NEWHOUSE, *supra* note 1; D. SALIBA, REAL ESTATE VALUATION IN COURT (1972); THE PROPERTY TAX AND ITS ADMINISTRATION (A. Lynn ed. 1969); Talcott, *Property Tax Equalization and Assessment: A Proposal for Reform*, 50 NEB. L. REV. 103 (1970); Wershow, *Recent Developments in Ad Valorem Taxation*, 20 FLA. L. REV. 1 (1967); Yudof, *The Property Tax in Texas Under State and Federal Law*, 51 TEX. L. REV. 885 (1973); *Nineteenth Annual Survey of Developments in Virginia Law: 1973-1974*, 60 VA. L. REV. 1443, 1607-08 (1974); Note, *Inequality in Property Tax Assessments: New Cures For An Old Ill*, 75 HARV. L. REV. 1374 (1962); Note, *Equality in Property Taxation—The Law, Practice and Prospects*, 11 NEW ENGLAND L. REV. 617 (1976).

[8] *See, e.g.*, WHYY, Inc. v. Borough of Glassboro, 393 U.S. 117, 119 (1968) (must be uniformity and equality in state's ad valorem property tax scheme or it is illegal); State Bd. of Tax Comm'rs v. Jackson, 283 U.S. 527, 537 (1931) ("[E]qual protection . . . does not compel the adoption of an iron rule of equal taxation [as long as] the discrimination is founded upon a reasonable distinction . . . ."); Louisville & Nashville R.R. v. Public Serv. Comm'n, 389 F.2d 247, 250-51 (6th Cir. 1968), *aff'g* 249 F. Supp. 894 (M.D. Tenn. 1966) (state and federal constitutions require assessment of property at its actual value); Town of Sudbury v. Commission of Corps. & Taxation, 321 N.E.2d 641, 645-46 (Mass. 1974) ("The duty of assessors is to assess property at its 'fair cash valuation' " in order to produce uniformity in valuation.); *In re* Kents 2124 Atlantic Ave., Inc., 34 N.J.

In recent years, there has been a rising interest in property tax reform in Mississippi. Studies have been conducted,[9] papers have been written,[10] lawsuits have been filed,[11] and bills have been introduced.[12] These efforts have done much to illuminate the magnitude of the problem, but they have done little to resolve it. Furthermore, the State Tax Commission has long warned the Mississippi taxing authorities of their vulnerability to judicial decree.[13] In 1971, the Honorable Robert A. Biggs, Jr., the former State Ad Valorem Tax Commissioner, addressed a conference of Mississippi's tax assessors and, after describing the recent Alabama[14] and Tennessee[15] tax equalization litigation, warned:

> We officers, at whatever level, have accepted our positions under oath to carry out our laws. We had all opportunity to understand the job and its legal implications and requirements before we asked the electorate

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21, 166 A.2d 763, 767-68 (1961) ("invidious" discrimination found in tax assessors' general practice of ignoring statutory duty to regularly revalue property); Smith v. Davis, 426 S.W.2d 827, 834 (Tex. 1968) (no constitutional requirement that different taxing authorities use same proportion of fair market value in assessment).

[9] *E.g.*, J. GRACE & F. TYNER, PROPERTY ASSESSMENT EQUALIZATION IN MISSISSIPPI, AGRICULTURAL AND FORESTRY EXPERIMENT STATION, MISSISSIPPI STATE UNIVERSITY (1975); D. MCKINNEY & P. LOWRY, *supra* note 1; MISSISSIPPI ECONOMIC COUNCIL, COUNTY ASSESSMENT PRACTICES (1971); U.S. BUREAU OF THE CENSUS, DEP'T OF COMMERCE, 1972 CENSUS OF GOVERNMENTS, TAXABLE PROPERTY VALUES PART 2 80-81 (1973).

[10] J. Grace, Impact of Assessment Equalization on County Revenue and Homestead Exemption Reimbursement in Mississippi (Aug. 1974) (unpublished thesis in Mississippi State University Library); S. Herren, Farmland Property Taxes Based on Use-Value Assessment (Aug. 1974) (unpublished thesis in Mississippi State University Library).

[11] *E.g.*, American Nat'l Ins. Co. v. Board of Supervisors, 303 So. 2d 457 (Miss. 1974); Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976); Standard Oil Co. v. Board of Supervisors, No. 9,414 (Cir. Ct. Jackson Cty., Miss., Dec. 18, 1975); Hairston v. Davis, No. 87,094 (Chan. Ct. 1st Dist. Hinds Cty., Miss., Oct. 20, 1972).

[12] *See, e.g.*, S. Con. Res. 547 (Miss. Reg. Sess. 1977); H.R. 1302 (Miss. Reg. Sess. 1977); H.R. Con. Res. 29 (Miss. Reg. Sess. 1976); H.R. 80, 195, 203 & 241 (Miss. Reg. Sess. 1976).

[13] *E.g.*, MISS. CODE ANN. § 97-11-37 (1972), which provides, *inter alia*:

> If any person, being . . . [an] assessor . . . or holding any county office whatever, . . . shall knowingly or wilfully fail, neglect, or refuse to perform any of the duties required of him by law, or shall fail or refuse to keep any record required to be kept by law, or shall secrete the same, or shall violate his duty in any respect, he shall, on conviction thereof, be fined not exceeding one thousand dollars, or be imprisoned in the county jail not exceeding six months, or both.

[14] *E.g.*, Weissinger v. Boswell, 330 F. Supp. 615, 625 (M.D. Ala. 1971) (violative of equal protection clause to allow local assessors the right to arbitrarily determine ratio at which property is assessed).

[15] *E.g.*, Louisville & N.R.R. v. Public Serv. Comm'n, 389 F.2d 247, 250 (6th Cir. 1968), *aff'g* 249 F. Supp. 894 (M.D. Tenn. 1968) ("[N]o state practice can supplant the constitutional guarantee in Tennessee that all property of every kind shall be assessed at its actual value.").

> for the job. If we do our duty, under the law, we leave no room for any disfavorable action; but if we fail, anything could happen.[16]

Approximately thirteen months later, Commissioner Biggs, in a letter addressed to all supervisors and tax assessors in the state, again warned:

> As we enter the new year, I want to again bring to your attention the serious question of equalization of assessments. It is unquestioned that we must continue, on our own initiative, to make progress on this problem. The probable alternative is operating under a federal court order.[17]

Against this background, a few Mississippi counties, no doubt with the best of intentions, have taken action.[18] Unfortunately, inadequate financial resources[19] and an inadequate understanding of the legal and economic complexities of the task of equitable tax assessment and property valuation have produced significant problems. In the vast majority of other counties in Mississippi, the task of divining order out of chaos is almost an impossibility. Nevertheless, the problems inherent in all of the Mississippi counties can be generally categorized.

First, there is a popular misconception among too many well-meaning people that reappraisal of property values is the answer to the existent ad valorem taxation problem.[20] But without a proper understanding and definition of "value,"[21] the most basic element in any

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[16] Address by Robert A. Biggs, Jr., Ad Valorem Tax Commissioner, Mississippi State Tax Commission, 1971 Assessors Conference (Dec. 1, 1971), *reprinted in* AD VALOREM AND HOMESTEAD DIV., MISSISSIPPI STATE TAX COMM'N (Regional Conference 1972).

[17] Letter from Robert A. Biggs, Jr. to the Board of Supervisors of Yazoo County, Mississippi (Jan. 9, 1973) (on file with the *Mississippi Law Journal).*

[18] The following Mississippi counties have recently undergone property tax reappraisals in whole or in part: Adams, Bolivar, DeSoto, Holmes, Jackson, LeFlore, Lincoln, Pike, Sunflower and Warren. Telephone Interview with Hurst Webb, Chief, Ad Valorem Division, Mississippi State Tax Commission (Jan. 13, 1977).

[19] It is statutorily provided that

> [t]he board of supervisors shall, at its first meeting of each quarter beginning on October 1, January 1, April 1, and July 1, appropriate a lump sum for the assessor and tax collector for the expenses of his office during the current quarter. The quarterly appropriation shall be one-fourth (1/4) of the amount approved in the annual budget unless the assessor and tax collector requests a different amount. Except in case of emergency, as provided in the county budget law, the appropriation for the quarter beginning in October of the last year of the assessor and tax collector's term shall not exceed one-fourth (1/4) of the annual budget.

MISS. CODE ANN. § 27-1-9 (Supp. 1976).

[20] The reappraisal process, however, simply increases the dollar value to which the county mill rate is applied. It erroneously places emphasis on increasing the aggregate number of dollars available for taxation rather than on an equitable distribution of the tax burden. This can be overcome, however, by valuing the land at its "true" or "actual" value and applying a uniform ratio to the specific class of land in question.

[21] See section I. *infra.*

property taxation system, any reappraisal effort is doomed to failure. Regrettably, even in the counties which have attempted to restructure their property valuation systems, their efforts have fallen short of success simply because value has continued to be defined in a manner that violates both logical statutory interpretation and basic economic principles.[22] Secondly, in their efforts at oversimplification, many counties have tried to assign uniform dollar values to general categories of land.[23] For example, there are certain counties in Mississippi which have recently undergone a reappraisal under which all rural cultivatable lands are arbitrarily valued at a specific dollar amount per acre.[24] This has been done in spite of the fact that the most desirable acreages in such counties have a value three or four times that of the least desirable acreages.[25] The inevitable result is that the property tax assessed is

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[22] A threshold consideration is understanding the difference between value and price. Each is significantly influenced by the other, but strictly the distinction between the two never fades.

> Value and price are influenced by each other, but they seldom coincide . . . . Price is the result of the impact of economic conditions on value.
>
> Value is more enduring than price and fluctuates less.

E. CROUSE & C. EVERETT, RURAL APPRAISALS 20 (1956).

The breakdown of this article into principal sections dealing, first, with value and, second, with uniformity and equality is suggested by the decision in Adams v. Mississippi State Bank, 75 Miss. 701, 23 So. 395 (1898), wherein the court stated:

> The whole scheme of taxation, as devised by [section 112 of the Mississippi Constitution], is plain, simple and easily understood. In order to carry out that design three things are necessary: (1) "Property must be assessed for taxes under general laws," because, without a legal assessment, no tax can lawfully be imposed or collected; (2) property must be assessed at its "true value." This must be done in order to prevent unjust discrimination by selecting different modes of valuation, as had occurred under the constitution of 1869 . . . . [W]hen these preliminary, but necessary, steps of assessment and valuation are taken, in order to complete and carry the plan into effect, the third rule is announced: (3) Property shall be taxed in proportion to its value, and taxation shall be equal and uniform. These are the three rules upon which the entire plan of taxation is reared; you cannot destroy one without marring the symmetry of the whole.

Id. at 720-21, 23 So. at 396. The general validity of assessment laws is not the concern here. Assessment at true value and uniform and equal assessment are as important as they are interrelated parts of the Mississippi system of ad valorem taxation.

[23] At least 26 counties in Mississippi assign a uniform dollar value per acre to cultivatable agricultural lands for ad valorem tax assessment, including: Alcorn, Amite, Clarke, Covington, Forrest, Franklin, George, Hancock, Issaquena, Itawamba, Jefferson, Jefferson Davis, Jones, Kemper, Lamar, Lowndes, Monroe, Montgomery, Panola, Rankin, Scott, Simpson, Tate, Tishomingo, Webster and Wilkinson. Sworn Affidavits of County Tax Assessors, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976).

[24] *E.g.*, Adams, Bolivar, DeSoto, Holmes, Jackson, Leflore, Lincoln, Pike, Sunflower and Warren counties. *Id.*

[25] Testimony of Wade S. Wineman, Record, vol. III, at 61-62, Davidson v. Baird, No.

unequally obtained. The person who owns the least desirable acreage is, in essence, shouldering a grossly unfair, higher percentage of the tax burden. Consequently, a county that does not provide for subclassification of general categories of property that clearly have widely varying values is obviously acting in a discriminatory manner. It is employing a taxation scheme that certainly defies a logical interpretation and application of value in any ad valorem taxation system. Third, the "true value" assigned to property for tax purposes continues to be substantially lower than the actual true value of the property. Furthermore, the assessed value is still lower.[26] The following example is illustrative of the gross disparity among actual, assigned and assessed property values typical in counties that have undergone reappraisal. A particular tract of farmland may have a true value of $750 per acre. It may be assigned a true value for tax purposes, however, of $200 per acre. If the county operates under a 25% assessment ratio, the assessed per acre value of the land is $50.[27] The mill rate in the county is then applied to the $50 per acre assessed value to determine the tax paid.[28]

These and many other problems continue to exist even in the few counties that have undergone reappraisal. In most of the other counties, the situation is so chaotic and the inequity so rampant that discovery of the type of ad valorem tax system imposed is next to impossible, thereby compounding the difficulty of attaining a logical, sensible solution. Therefore, the purpose of this article is, first, to expose the problems inherent in Mississippi's ad valorem taxation system. Specifically, it will concentrate on the inadequate understanding of the term "value" and demonstrate how such misunderstanding significantly contributes to intracounty and intercounty assessment ratio discrimination. Sec-

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10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976). *See also* S. Herren, *supra* note 10, at 68, Table 9.

[26] The term "assessed value" will hereinafter be used to indicate the assigned property value to which the mill rate is applied. Thus, true value and assessed value should be synonymous. However, in Knox v. Southern Paper Co., 143 Miss. 870, 108 So. 288 (1926), the court recognized that

> [i]t is a matter of common knowledge in this state that the assessing officers of the state systematically and universally assess property in the state at a lower level than its true value.

Id. at 879, 108 So. at 290.

[27] The "assessment ratio" is the ratio of the assessed value to the true value, *i.e.* the percentage of true value used for computing assessed value. For example, if a parcel of land has a true value of $500 per acre and is assigned an assessed value of $50 per acre, the assessment ratio is determined by dividing $500, the full true value, into $50, the assessed value. The assessment ratio thus equals 10%.

[28] The "mill rate" is the rate applied by the county board of supervisors to assessed value for purposes of computing the actual tax. It may be more meaningfully referred to as the "tax rate." *See, e.g.*, MISS. CODE ANN. §§ 19-9-97, -99, -101, -105, -109 (1972).

ondly, the judicial response to these and similar problems in Mississippi and her sister states will be discussed. Finally, specific suggestions will be offered that will make workable, equitable and understandable, the crazy quilt that is Mississippi's ad valorem taxation system.

I. Value

Value[29] plays a seminal role in any system of ad valorem taxation.[30] It is the foundation upon which to structure a taxation scheme.[31] Consequently, the degree of care and expertise used in formulating a logical, workable definition of value, as well as in its consequent application, will inevitably reflect the fairness inherent in such a taxation system.

A. The Mississippi Statutory Law

In practice, the definition and determination of value in Mississippi largely have been left to the discretion of the county tax assessor.[32] Nevertheless, his duties in valuing and assessing real property for taxation purposes are statutorily adumbrated.[33] The statute clearly provides, *inter alia*, that such "land shall be assessed according to its *true value*."[34] In determining true value,[35] all facts that relate to value should

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[29] "The standard measure of value when properly determined may be 'science,' but the ultimate determination of just value is 'art.'" Powell v. Kelly, 223 So. 2d 305, 309 (Fla. 1969). In this article, value, for ad valorem tax purposes, is denominated "true value" because that phrase is used in the statutes applicable to ad valorem taxation. See Miss. Code Ann. §§ 27-35-49, -97, -113, -115, -143, -149, -301 (1972). *See generally* E. Crouse & C. Everett, *supra* note 22, at 325-40.

[30] *See generally* W. Newhouse, *supra* note 1; Santemma, *Review of Real Estate Tax Assessments*, 2 Real Est. L.J. 685 (1974); Smith, *Issues and Problems in the Valuation of Real Estate*, 30 N.Y.U. Inst. Fed. Tax. 209 (1972); Talcott, *supra* note 7; Yudof, *supra* note 7.

[31] This fact was recognized by the Florida Supreme Court when it stated:

> We now, for the special attention of the 59 assessors who seem not to have brought assessable values up to 100 per cent. repeat from the Walter decision language we thought was clear: "It is apodictic that a percentage of 'X' [the true assessable value] cannot be computed *without first establishing 'X'* and the assessors upon reaching the first figure are enjoined not to proceed to the second."

Burns v. Butscher, 187 So. 2d 594, 596 (Fla. 1966) (emphasis added).

[32] It is not an unduly harsh criticism to suggest that there are tax assessors in Mississippi who, because of their lack of education or professional training, have *no* definition of value in mind while assessing properties.

[33] Miss. Code Ann. § 27-35-49 (1972). In this article, the primary concern is with the taxation of real property and improvements situated thereon. Section 27-35-49 provides that real property shall be assessed according to its "true value." Personal property, however, is governed by a different statute, *id.* § 27-35-29, which commands that it be assessed at its "cash value."

[34] *Id.* § 27-35-49 (emphasis added).

be considered. While the statute enumerates certain specific criteria which must be taken into account, it makes it clear that "any other circumstances that tend to enhance [the property's] value," in addition to the specific factors enumerated, should be considered. Construing this language loosely, the factors may include the actual, potential or typical uses of the property, the reasons for typical owners holding the property, and the availability of the relevant value determining data. Consideration of such factors is consistent with the primary concept that lands shall be assessed at true value and that all factors shedding light on true value, whether it be in the eyes of an appraiser, an assessor, an owner, or a knowledgeable buyer or seller, should be considered.

A major weakness of the statute is that it simply offers considerations to be taken into account when assessing the value of the land, inevitably subjecting its provisions to the arbitrary interpretation of eighty-two different county tax assessors. The usual result of such discretionary leeway was acknowledged by the New Jersey Supreme Court when it was confronted with the inequitable practices flowing from essentially the same type of taxation system employed in Mississippi.[36] The court lambasted the neglect exhibited by the tax assessors in their disregard of the duty to revalue property for taxation:

> The testimony of the assessors in the present case reveals a total indifference to their statutory duty. The assessment rolls were copied year after year, with no effort to achieve a general revaluation. Thus inequalities due to progressive inflation, changing neighborhood fortunes and perhaps other causes, were perpetuated . . . . They could hardly have been unaware of available evidence of widely varying ratios disclosed by reported sales in their community. The record shows the assessors received such data, which they carefully filed and wholly ignored.[37]

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[35] While no precise definition of "true value" is specified by statute, the tax assessors are instructed that in assessing land according to its true value, they are to consider

> the improvements thereon, the proximity to navigation, to a highway, to a railroad, to a city, town, village, or road, *and any other circumstances that tend to enhance its value*, and not at what it might bring at a forced sale, but what the owner would be willing to accept and would expect to receive for it if he were disposed to sell it to another able and willing to buy.

Id. (emphasis added). Although each of these factors should be considered in determining the value of real property, they must be relatively, rather than absolutely, applied. They should not, however, alter the primary concept that lands shall be assessed according to true value, considering *all* factors relative to the subject property. *See* section I. *C. infra.*

[36] *In re* Kents 2124 Atlantic Ave., Inc., 34 N.J. 21, 166 A.2d 763, 765 (1961).

[37] 166 A.2d at 767-68. A disturbingly similar evaluation was made by the Florida Supreme Court when it assessed the extent to which Florida's taxation system had encountered the problems in valuation patently present in Mississippi's ad valorem system.

A detailed examination of the Mississippi statutes makes it apparent that the county tax assessor is not intended to possess the unbridled discretion in valuation which he now exercises. Instead, the legislature has provided supervisory constraints to be used by the county boards of supervisors and, if necessary, by the State Tax Commission to ensure that the ad valorem taxation system functions fairly and equitably. Specifically, the general tone sounding throughout the relevant statutory law legally obligates the board of supervisors in each county

> to make such changes in assessments as will cause the taxes to be charged to the person or property liable therefor, *and to fix the assessments of property according to the true value* thereof, to the end that all property shall be assessed and taxed equally and uniformly.[38]

It is further provided by statute that the State Tax Commission shall examine the assessment rolls of each county in Mississippi.[39] While acting in this capacity, the Commission's primary role is to ensure that the assessed valuation of the same classes of property "in any one or more counties of the state is . . . equal and uniform with the assessed values fixed upon the same classes of property in other counties of the state."[40] Again, "true value" is the touchstone. There is no difficulty, therefore, in determining the State Tax Commission's legal duty and obligation: To promote uniformity and equality in the state's taxation scheme, the Commission is to ensure that all taxable property in *every* county is "assessed generally *at its true value.*"[41] As one court aptly stated,

> [t]he standard of true value is but a means of realizing uniformity and equality, the preeminent consideration in the apportionment of the tax burden in virtue of the constitutional guaranties of due process and the equal protection of the laws.[42]

Any deviation by the Tax Commission from the course plotted by the legislature is a violation of the law.[43]

> The exercise of the duty to establish values, carte blanche, would bring strange results as indeed, has been the case. Exercise of unbridled discretion by 67 Tax Assessors without their being anchored to any master plan would result in the imbalance already so clearly indicated.

Burns v. Butscher, 187 So. 2d 594, 595-96 (Fla. 1966).

[38] MISS. CODE ANN. § 27-35-149 (1972) (emphasis added); *see, e.g., id.* §§ 27-35-83 (boards of supervisors shall equalize tax rolls); -87 (delineates role of boards of supervisors in equalization); -97 (boards of supervisors can compel introduction of any information relevant to determination of true value of subject property).

[39] *Id.* § 27-35-113.

[40] *Id.*

[41] *Id.* (emphasis added).

[42] Switz v. Township of Middletown, 23 N.J. 580, 130 A.2d 15, 22 (1957).

[43] It is thus clear that the ad valorem taxation system is to be policed not only by

Although section 27-35-49, the key definitional statute in ad valorem taxation, is vague, it nevertheless possesses a degree of flexibility which, in the hands of the proper public servants, could become a blessing. This is simply attributable to the fact that the true value concept, incorporated in the statute, is sufficiently flexible to permit the legitimate inclusion of sound economic principles into the search for ad valorem tax value.[44]

B. The Supreme Court of Mississippi: Its Approach to Valuation

There is a paucity of definitive judicial analysis in Mississippi as to what constitutes "true value" in a real property taxation context. The Supreme Court of Mississippi has, however, expressly acknowledged that the ultimate objective in the process of ad valorem tax assessment is the determination of the particular property's true value.[45] In making that determination, the court explicitly stated in *McArdle's Estate v. City of Jackson*[46] that "'any . . . circumstances that tend to enhance' . . . the condition of the property, its surroundings, its improvements, and capabilities may be considered."[47] In *McArdle's Estate,* the taxpayer argued that true value should be determined only with reference to the income or rental value of the subject property. The supreme court correctly rejected this narrow approach, recognizing that "income or rental value of real property is *one* proper element for consideration in determining its [true] value."[48] It was quick to add, however, that "this factor is *not* the sole criterion, and all other relevant factors should be considered in determining valuation."[49]

While *McArdle's Estate* recognized that earning capacity is one

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the county tax assessors, but also, to a significant extent, by both the county boards of supervisors and the State Tax Commission. Therefore, the blame for the system's inequality and lack of uniformity may justifiably be cast upon the group as a whole rather than solely upon the assessors.

[44] See Paras v. City of Portsmouth, 115 N.H. 63, 335 A.2d 304 (1975). In *Paras,* the court held that flexibility is allowed in making value determinations of taxable property.

> Since the statutes are silent about the method or combinations of methods to be used in making value estimations, this court, as well as others, has permitted considerable leeway . . . . Reproduction or replacement cost methods are acceptable . . . . Income-producing power of property can be another standard in fixing value . . . . The comparable sales method may also be used . . . . But all relevant factors to property value should be considered when making an appraisal in order to arrive at a just result.

335 A.2d at 307-08 (citation omitted).

[45] McArdle's Estate v. City of Jackson, 215 Miss. 571, 579, 61 So. 2d 400, 402 (1952).

[46] 215 Miss. 571, 61 So. 2d 400 (1952).

[47] *Id.* at 579, 61 So. 2d at 402 (citations omitted).

[48] *Id.* (emphasis added) (citations omitted).

[49] *Id.* (emphasis added).

element of true value, a more recent supreme court decision has, *sub silentio,* acknowledged a broader approach to value. In *American National Insurance Co. v. Board of Supervisors,*[50] the court confronted the legality of the assessments against the Edgewater Plaza shopping center in Harrison County. The tax assessor testified that he had considered a number of factors in assessing the taxpayer's property: (1) the cost per square foot of construction; (2) the traditional income approach, emphasizing an average rental value per square foot; (3) the cost of replacing the shopping center; (4) the amount of insurance coverage on the property; and (5) certain other intangible and "enhanceable" values.[51] In other words, the tax assessor used the cost[52] and income approaches[53] coupled with a consideration of various other factors in determining true value. With respect to other comparable properties, however, the evidence reflected that the tax assessor had used only the cost approach.[54] This assessment procedure was struck down by the court as violative of the equality and uniformity clause[55] because of its unequal application to similar types of property.[56] In dicta, however, the court clearly stated that if these factors had been uniformly applied to similar types of property, no violation would have been found.[57]

McArdle's Estate authorized a consideration of income-producing capacity[58] in property valuation. *American National* implicitly approved the cost approach,[59] considered alone or in conjunction with other factors, as long as all similar properties are treated alike. The third accepted approach to value is the market data approach.[60] This approach to value is also generally considered an appropriate element in determining the true value of certain classes of property.[61] Indeed, as has been recognized by the Supreme Court of Mississippi,[62] its consideration

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[50] American Nat'l Ins. Co. v. Board of Supervisors, 303 So. 2d 457 (Miss. 1974).

[51] *Id.* at 459.

[52] *See* note 77 and accompanying text *infra.*

[53] *See* note 76 and accompanying text *infra.*

[54] 303 So. 2d at 458-59.

[55] *See* section II. *B. infra*; *cf.* Xerox Corp. v. City of Jackson, 328 So. 2d 330, 332 (Miss. 1975) (when practical, the market value approach should be used in assessing personal property); City of Cleveland v. T.V. Cable Co., 239 Miss. 183, 190, 121 So. 2d 862, 864 (1960) (for purposes of personal property ad valorem taxation, actual value and true value are synonymous with market value).

[56] 303 So. 2d at 460.

[57] *Id.* at 459-60.

[58] *See* note 76 *infra.*

[59] *See* note 77 *infra.*

[60] *See* note 75 *infra.*

[61] *Id.*

[62] *E.g.,* City of Clarksdale v. Stuart, 184 Miss. 179, 185 So. 588 (1939). In *City of Clarksdale,* the court, recognizing a "large latitude" in valuing property, approved the market value approach. *Id.* at 181, 185 So. at 588.

seems mandated by the assessment statute.[63]

Mississippi has no definitive decision delineating the full parameters and implications of the true value concept embodied in the assessment statute. The existing statutory law does, however, provide sufficient flexibility for the court to logically inject sound economics and law into Mississippi's ad valorem taxation system.[64] It allows the court to reach the conclusion reached by the Supreme Court of New Hampshire when confronted with essentially the identical problem prevalent in Mississippi.[65]

> Since the statutes are silent about the method or combinations of methods to be used in making value estimations, this court, as well as others, has permitted considerable leeway. . . . Reproduction or replacement cost methods are acceptable. . . . Income-producing power of property can be another standard in fixing value. . . . The comparable sales method may also be used. *But all relevant factors to property value should be considered when making an appraisal in order to arrive at a just result.*[66]

The problems inherent in Mississippi's assessment statute are largely attributable to the relatively unsophisticated economics of the era in which it was drafted.[67] This has inevitably led to problems in interpretation which have been well illustrated by the court's partial acceptance of all three generally recognized methods of property valuation.[68] In order to bring some semblance of order and reasonableness to the statutory assessment scheme, however, it is necessary to carefully delineate the proper valuation methods to be utilized in the tax assessor's determination of the true value of taxable property.

C. Assessment at True Value: The Economic Principles

The determination of value in any context is ultimately a question of economics. This is no less true in ad valorem taxation, although the

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[63] MISS. CODE ANN. § 27-35-49 (1972).

[64] *Id.*

[65] Paras v. City of Portsmouth, 115 N.H. 63, 335 A.2d 304 (1975).

[66] 335 A.2d at 307-08 (emphasis added)(citations omitted).

[67] Mississippi's present assessment statute, MISS. CODE ANN. § 27-35-49 (1972), has essentially remained unchanged in pertinent part since 1871. REV. MISS. CODE § 1675 (Campbell's 1871) provided:

> Lands shall be assessed once in every four years, according to the intrinsic value, to be judged of by the owner or person having possession or charge thereof, on oath, taking into consideration the improvements, also the proximity to navigation, or to any town, city, village or road, and any other circumstance that may tend to enhance the value, and not at what it might bring at a forced sale, but what he would be willing to accept and expect to get for it, if he were disposed to sell it.

[68] See notes 75 through 77 and accompanying text *infra.*

definition of value must derive from a statute.[69] The Mississippi statute that defines value is far from a model of clarity. Yet, it contains sufficient resilience to allow a realistic incorporation of sound economic principles through judicial construction. The general substance of those principles will be introduced and examined below in an effort to suggest a workable and equitable ad valorem taxation system.

First and foremost, true value and price must be carefully distinguished. "Price is the result of the impact of economic conditions on value. Value [specifically true value] is more enduring than price and fluctuates less."[70] Although value has no universal meaning,[71] sound economic principles require that, before defining value, the purpose for which value is being determined should be kept clearly in mind.[72] In an ad valorem tax context, the assessor should seek to ascertain the endur-

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[69] Each state has the prerogative of establishing its own definition of "value." Some states have opted for "fair market value" as that concept is generally understood within the appraisal profession. The most popular definitions of market value are:

> 1. . . . the highest price estimated in terms of money which a property will bring if exposed for sale in the open market, allowing a reasonable time to find a purchaser who buys with knowledge of all the uses to which it is adapted and for which it is capable of being used.
> 2. . . . the price at which a willing seller would sell and a willing buyer would buy, neither being under abnormal pressure.
> 3. . . . the price expectable if a reasonable time is allowed to find a purchaser and if both seller and prospective buyer are fully informed. . . .

AMERICAN INST. OF REAL ESTATE APPRAISERS, THE APPRAISAL OF REAL ESTATE 25 (6th ed. 1973) [hereinafter cited as THE APPRAISAL OF REAL ESTATE], *quoting* AMERICAN INST. OF REAL ESTATE APPRAISERS, APPRAISAL TERMINOLOGY AND HANDBOOK 131 (5th ed. 1967). Others have selected "use value assessment," *i.e.* "the assessment of property upon the basis of its value in a particular (current) use, rather than upon the basis of its market value." INT'L ASSOC. OF ASSESSING OFFICERS, USE-VALUE FARMLAND ASSESSMENT THEORY, PRACTICE, AND IMPACT 57-58 (1974). Mississippi has chosen "true value." Although it is a vague term, "true value" connotes a basic or enduring value. *See generally* Jones, *Just Compensation Via Fair Market Value May Not Include the Kitchen Sink—It Could Be Noncompensable,* 46 MISS. L.J. 1 (1975).

[70] E. CROUSE & C. EVERETT, *supra* note 22, at 20. In Mississippi, it is the statutory duty of the tax assessor to determine the true value of taxable property, not just the price at which it has sold or will sell. MISS. CODE ANN. § 27-35-49 (1972) ("It shall be the duty of the tax assessor to assess all the lands in his county . . . according to [their] true value . . . .").

[71] *See, e.g.,* THE APPRAISAL OF REAL ESTATE, *supra* note 69, at 24, 56. A most helpful chart distinguishing and comparing the different kinds of value—basic value, fair market value, liquidation value, present sale value, loan value and tax value—appears in E. CROUSE & C. EVERETT, *supra* note 22, at 269.

[72] *Cf.* R. SUTER, THE APPRAISAL OF FARM REAL ESTATE 119 (1974) (first step in making an appraisal involves definition of the client's problem and specification of the purpose of and reason for the appraisal). *See generally* THE APPRAISAL OF REAL ESTATE, *supra* note 69, at 49-72.

ing value of the property.[73] This is best determined by considering the property from the vantage point of its value in the hands of a *typical* owner, not necessarily the present owner, over at least several years.[74] Once the purpose for which value is being determined is firmly in mind, it is then necessary to determine the proper valuation methods to apply in reaching true value.

Classically, there are three accepted approaches to the determination of value: (1) the market data or comparative sales approach;[75] (2) the income or earnings approach;[76] and (3) the cost approach.[77] An eco-

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[73] E. CROUSE & C. EVERETT, *supra* note 22, at 330 (points out that in practice tax "values do not follow the extreme fluctuations of market value," nor should they).

[74] The "typical operator" concept is basic to an accurate farm appraisal. The following is an accurate explanation of the concept.

> The word "typical" refers to those characteristics which will most frequently occur or most likely exist in the future in the situation under consideration. The typical operator is the most likely person who will own or operate the farm, assuming the ownership of such is sold or transferred today. The typical operator is not necessarily the present owner or operator.

R. SUTER, *supra* note 72, at 125. It should thus be emphasized that the assessor should value property according to the typical income that it would yield the owner, not what it has actually yielded, regardless of the magnitude of the income. This idea was well stated by the New Jersey Board of Tax Appeals: "Low or no net income of a business because of poor management is no more an index of true value of realty than spectacular profits resulting from managerial perspicacity." Jersey City v. Harborside Warehouse Co., 19 N.J.M. 222, 17 A.2d 572, 577 (B.T.A. 1941), *aff'd*, 128 N.J.L. 263, 25 A.2d 291 (1942). *See also* E. CROUSE & C. EVERETT, *supra* note 22, at 24-32.

[75] The market data approach involves an analysis of actual arm's length sales of property similar to the subject property. An application of this approach involves five basic steps:

> 1. [Seek] out similar properties for which pertinent sales, listings, offerings, and/or rental data are available.
> 2. [Ascertain] the nature of the conditions of sale, including the price, terms, motivating forces, and its bona fide nature.
> 3. [Analyze] each of the comparable properties' important attributes with the corresponding ones of the property being appraised, under the general divisions of time, location, and other characteristics, including physical and economic.
> 4. [Consider] the dissimilarities in the characteristics disclosed in Step 3, in terms of their probable effect on the sale price.
> 5. [Formulate] in the light of the comparisons thus made, an opinion of the relative value of the subject property as a whole, or, where appropriate, by applicable units, compared with each of the similar properties.

THE APPRAISAL OF REAL ESTATE, *supra* note 69, at 67-68. *See also* INT'L ASSOC. OF ASSESSING OFFICERS, ASSESSING AND THE APPRAISAL PROCESS 62-78 (5th ed. 1974) [hereinafter cited as ASSESSING AND THE APPRAISAL PROCESS]; R. SUTER, *supra* note 72, at 293-326.

[76] The income or earnings approach determines value by reference to the property's income-producing capacity under *typical* management. This approach, when utilized to determine value in an agricultural land context, is explained at notes 96 & 97 and accompanying text *infra*. In a commercial rental context, the four steps basically followed are:

> 1. Obtain the rent schedules and the percentage of occupancy for the subject

nomically sound determination of the value of any property should, if at all possible, include some consideration of each of these approaches.[78] This remains true whether the property is appraised for the purpose of collateral in obtaining a loan, for sale or for ad valorem taxation.

Valuation of lands for ad valorem tax purposes is a special and mysterious process to both the appraiser and the lawyer.[79] The over-

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property and for comparable properties for the current year and for several past years. This information provides gross rental data and the trend in rentals and occupancy. This data is then compared and adjusted to an effective estimate of gross income which the subject property may reasonably be expected to produce.

2. Obtain expense data such as taxes, insurance, and operating costs being paid by the subject property and by comparable properties. The trend in these expenses is also significant.

3. Estimate the remaining economic life of the building to establish the probable duration of its income, or, alternately, estimate the suitable period of ownership before resale.

4. Select the appropriate capitalization method and the applicable technique and appropriate rate for processing the net income.

THE APPRAISAL OF REAL ESTATE, *supra* note 69, at 67-68. *See also* ASSESSING AND THE APPRAISAL PROCESS, *supra* note 75, at 62-78; E. CROUSE & C. EVERETT, *supra* note 22, at 24-38; R. SUTER, *supra* note 69, at 293-326.

[77] The cost approach involves a determination of the "current" cost of reproducing property less loss in value from deterioration and functional and economic obsolescence—accrual depreciation. There are five basic steps involved in this approach:

1. The estimate of the *land value* as if vacant
2. The estimate of the current *cost of reproducing* or *replacing* the existing improvements
3. The estimate of accrued depreciation from all causes
4. Deduction of accrued depreciation estimate to arrive at indicated value of improvements
5. The addition of the land value to the indicated value of the improvements to develop indicated property value.

THE APPRAISAL OF REAL ESTATE, *supra* note 69, at 65. *See also* ASSESSING AND THE APPRAISAL PROCESS, *supra* note 75, at 45-61; R. SUTER, *supra* note 72, at 329-350.

[78] THE APPRAISAL OF REAL ESTATE, *supra* note 69, at 64. When at all possible, all three approaches to value should be used by the tax assessor when valuing property as a "check against each other." *Id.* Under no circumstances, however, should the results of the three approaches be averaged.

> It would be as illogical to do so as to ask three persons for the right time, and average the three replies. The [tax assessor should consider] the relative applicability of each of the three approaches to the final estimate of defined value.

Id. at 71; *accord,* ASSESSING AND THE APPRAISAL PROCESS, *supra* note 75, at 23.

[79] *See* THE APPRAISAL OF REAL ESTATE, *supra* note 69, at 3 ("An appraisal of value is an estimate. It is an opinion."); ASSESSING AND THE APPRAISAL PROCESS, *supra* note 75, at 18 ("A convincing appraisal is based on the integrity and competence of the appraiser and the soundness and skill with which he processes the available pertinent data."); R. SUTER, *supra* note 72, at 53, wherein the author states:

> Value is what some person thinks something is worth. It is not inherent in the term itself. It is created, it exists, it is maintained, it is modified, and it is

whelming majority of appraisals today are made for the purpose of ascertaining the property's value in contemplation of a sale, whether it be public, private or forced. The term used to describe the value so determined is "fair market value." The emphasis, both psychologically and in fact, is placed on the word "market." Although a proper determination of fair market value involves a consideration of the three basic approaches to valuation, the heaviest weight is placed on the activities of the marketplace. This is particularly true in times of inflation. In an ad valorem tax context, however, the property is neither being sold nor is it intended to be sold. Rather, a tax is to be assessed according to the property's true value. This proceeds from the assumption that the true value of one's property is a fair indication of his ability to contribute to the cost of public services. But, unlike the income tax, the ad valorem tax is not paid out of that which is the subject of the tax. Instead, an ad valorem property tax, excepting those imposed on residential property, is usually paid out of the funds earned through the use of the assets by which the amount of the tax is measured. From this perspective, there is a certain inequity in taxing whatever speculative value the taxpayer's property may have, since that value is inaccessable to him when the tax becomes due. Speculative future value will not cover an overdraft at the bank.

During an inflationary era, an overemphasis on market considerations in determining value for tax purposes will inevitably force some responsible taxpayers to sell their property in order to avoid an overburdensome tax. No rational tax policy contemplates a tax structure that will "force" the owner to sell his property, *i.e.* that will force real property to find its highest and best use in order to pay the taxes due. Public policy is certainly consistent with the notion that our society benefits when properties such as residential property, timberland and agricultural cultivatable land are not devoted to their highest and best use. The tax assessor must, therefore, avoid seeking short run market value. Rather, the enduring, long range value of property, from the vantage point of a typical owner, should be the objective. This point was well recognized in *Harborside Warehouse Co. v. Jersey City*:[80]

> The prosecutor contends that . . . the criterion of true value is determined by the selling price . . . . "The basic weakness of this

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destroyed, but only in the mind of man. The value or worth of an item is an opinion. That opinion may be a personal one in which the person making the judgment largely ignores the real world; or, that opinion may be a well-researched one in which the person making the judgment draws heavily on an analysis of the market.

Id.

[80] 128 N.J.L. 263, 25 A.2d 291, *aff'd*, 129 N.J.L. 62, 28 A.2d 91 (1942).

> attack is that prosecutors proceed on the theory that exchange value or market value is the invariable test of true value under all circumstances. This is not so. . . . '[T]rue value is not always to be ascertained by reference to selling price; . . . special circumstances may increase or depress market value without affecting true value or vice versa.' "[81]

Thus, it may have been no accident that value, in the context of ad valorem property taxation, is statutorily denominated "true value" in Mississippi and that the terms "fair market value" and "market value" are to be found nowhere within the more than 100 pages in the Mississippi Code which specifically address this area of the law.[82]

Since the term fair market value is often misunderstood as being synonymous with true value, it is important to clearly distinguish them for the purposes of ad valorem taxation. The following chart, comparing the effect of various factors on value, illustrates the differences between these two types of value.[83]

Factors Affecting Value	Fair Market Value	True Value/ Assessed Value
Period of time considered	Favorable	Usually by statute
Kind of operator	Somewhat above typical	Typical
Type of operation	Usually better than customary	Typical
Use	Emphasis on highest and best use	Emphasis on Current use
Prices of products	Immediate past	Long average
Crop yields	Immediate past	Probable long average
Future anticipations	Some, especially favorable ones	None
Hazards	All	All
Location	Emphasize favorable	Actual value
Home uses	Emphasize favorable	Actual value

[81] 25 A.2d at 292 (citation omitted).

[82] Miss. Code Ann. §§ 27-35-1 to -711 (1972 & Supp. 1976).

[83] Source: E. Crouse & C. Everett, *supra* note 22, at 269.

It is obvious that value has many faces, the appropriate one being dependent upon the context in which it is used. Since the lawyer is predominantly confronted with the valuation process in condemnation litigation, it is useful to contrast its application in this context with its correct application in an ad valorem taxation context.

In a condemnation or eminent domain context, a forced sale is theoretically made at a price determined as though the sale were not forced. The court attempts to determine the price that the owner would receive in the traditional willing-buyer, willing-seller open market situation. Accordingly, the market data or comparable sales approach is preferable, provided the requisite data is available and the property is of a type for which there is an established market. Indeed, the value ascertained by reference to comparable sales is the most important component of the condemnation value. Also, since the condemnation process is essentially a sale, it is legitimate to consider value on the basis of highest and best use as distinguished from actual use.[85]

In an ad valorem taxation context, where the property is not sold nor is it to be sold, market data assumes a lesser role. In the case of cultivatable agricultural lands, for example, such lands are, in the short run, typically held for income production and, in the long run, typically held for a combination of income production and investment. In this context, the earnings capacity of the land under farm uses in the hands of a typical owner is a rational point of departure for the determination

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[84] *Id.* at 310-13; R. SUTER, *supra* note 72, at 526-28.

[85] THE APPRAISAL OF REAL ESTATE, *supra* note 69, at 132; *see* Mississippi State Highway Comm'n v. Brooks, 239 Miss. 308, 123 So. 2d 423 (1960). In *Brooks* the court stated:

> The rule is well settled that the present value of land sought to be condemned in eminent domain proceedings is not to be estimated simply with reference to the condition in which the owner has maintained it or for the use to which it is at the time applied, but with reference to any use to which it is reasonably adapted. *The best or most valuable use* to which the property, which is taken for the public use, is adapted, should be considered.

Id. at 316-17, 123 So. 2d at 427 (emphasis added), *quoted with approval in* Green Acres Memorial Park v. State Highway Comm'n, 246 Miss. 855, 865-66, 153 So. 2d 286, 290-91 (1963). Throughout the condemnation cases, the term "fair market value" is regularly used. For example, in *Green Acres Memorial Park,* the following appears:

> Market value means the fair cash, market value as between one who wants to purchase and one who wants to sell, or the amount for which it would actually sell at the time . . . .

Id. at 861-62, 153 So. 2d at 289.

As indicated elsewhere in this article, see note 69 and accompanying text *supra*, the term "fair market value" does not appear in the ad valorem tax statutes relating to real property in Misissippi. Instead, the term "true value" is used. The reason for the distinction made here is that, in a condemnation case, the attempt made is to simulate an actual sale, while, in an ad valorem taxation context, the tax assessor should contemplate the underlying value of the property under typical management.

of value, with current use accorded far more weight than potential use.[86]

It must also be remembered that there are different types of real property subject to ad valorem taxation, *e.g.*, commercial, industrial, agricultural and residential. True value for one class of property is not necessarily computed or determined in the same manner as true value for another class. For example, the typical owner of commercial or industrial real estate is in a position to pass on the tax to consumers, whereas the typical owner of residential real estate has no income-producing capacity and must personally absorb the tax. In the case of cultivatable agricultural real estate, the typical owner has sufficient income-producing capacity but has no immediate power to pass on the tax to the public. This is obviously due to the economic differences in property. Therefore, because of these obvious differences in property and the varying purposes to which differing properties are put, a sound economic approach to value requires the utilization of each of the valuation methods. Clearly, when the value of each taxable parcel of property is determined in an economically sound manner, an economically fair and equitable distribution of the tax burden is attained. Consequently, the goal of the equal protection clause of the fourteenth amendment[87]

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[86] For an interesting discussion of the differences between "current use" and "future speculative use," see Lanier v. Walt Disney World Co., 316 So. 2d 59 (Fla. Dist. Ct. App. 1975), *cert. denied*, 330 So. 2d 59 (Fla. 1976). The Florida court stated that

> "[b]y authorizing tax assessors to consider, as one of the factors in arriving at a just valuation of property, the use to which the property 'can be *expected* to be put in the *immediate future*' the Legislature has, under the familiar rule of expressio unius est exclusio alterius, prohibited tax assessors from considering potential uses to which the property is reasonably susceptible and to which it might possibly be put in some future tax year or, even, during the current tax year. To be considered, the use must be *expected* not merely potential or a reasonably susceptible type of use; it must be expected *immediately*, not at some vague uncertain time in the future. The reason for the legislative policy in this respect was well stated by Judge White in his scholarly dissenting opinion in *Lanier v. Tyson*, . . . 147 So. 2d 365, [377, 379 (White, J., dissenting)], as follows:
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> 'Assessed valuations of land based on estimates of its highest and best potential, as distinguished from present bona fide use, are bound to be largely conjectural; and when an assessor, contrary to legislative intent and direction, determines the land despite its present value because of its potential for some other "higher" purpose, he indulges in unwarranted speculation and does violence to the constitutional and statutory objective of just valuation. The assessor, like the courts, should operate within the record and not *de hors* it.'"

316 So. 2d at 64 (citations omitted).

[87] U.S. CONST. amend. XIV provides in pertinent part:

> No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person within its jurisdiction the equal protection of the laws.

and the uniformity and equality clause of Mississippi's state constitution is preserved.[88]

D. *Cultivatable Agricultural Property: An Illustration of the Correct Implementation of Value in Ad Valorem Taxation*

The following is a rough step-by-step implementation of the approach to value proposed in the context of cultivatable agricultural lands.[89] Because of the nature of the property taxed and the reasons typical persons hold such property, the utilization of an income capitalization approach to value, supported by market data, will most accurately yield the true value of the property. The Deity having made the land, a cost approach obviously is unworkable.

1. The Grouping of Soils

Because the tax assessor must value thousands of parcels of land, individual appraisals are not practical.[90] Thus, establishing general, but sufficiently distinguishable, soils groupings is necessary.[91] The number of groupings depends upon the diversity of property in the taxing district. There is no magic number. Perhaps the best general rule of thumb is that there should be enough soils groupings so that differences among groups are greater than differences within each group.[92]

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[88] MISS. CONST. art. 4, § 112 provides in pertinent part:

> Taxation shall be uniform and equal throughout the state. Property shall be taxed in proportion to its value. Property shall be assessed for taxes under general laws, and by uniforms rules, and in proportion to its value.

[89] One reason for selecting farm lands for this analysis is that they are so plentiful in Mississippi. Consequently, much of the land subject to ad valorem taxation is cultivatable agricultural land. Numerically, rural tracts rank second only to residential properties on the state's tax rolls. Telephone Interview with Hurst Webb, Chief, Ad Valorem Division, Mississippi State Tax Commission (Feb. 18, 1977). Moreover, the approach to taxation commonly in use is so arbitrary—involving the valuation of lands at a fixed dollar amount per acre—that a workable, equitable recourse is badly needed.

[90] For a general description of the mass appraisal technique in ad valorem tax context, *see* E. CROUSE & C. EVERETT, *supra* note 22, at 325-66; R. SUTER, *supra* note 72, at 426-36. *See generally* ASSESSING AND THE APPRAISAL PROCESS, *supra* note 75, at 4-5; Testimony of Robert C. Suter, Record, vol. II, at 335-37, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976).

[91] R. SUTER, *supra* note 72, at 430; S. Herren, *supra* note 10, at 51-57.

[92] Suter suggests a minimum of five groupings. R. SUTER, *supra* note 72, at 430. The Soils Management Groupings complied at Mississippi State University called for more groupings of delta soils than loess (hill) soils. S. Herren, *supra* note 10, at 51. The Soil Survey for Washington County divides the soils into 22 capability units. U.S. DEP'T OF AGRICULTURE, SERIES 1958, No. 3, SOIL SURVEY, WASHINGTON COUNTY, MISSISSIPPI (May 1961). By utilizing as many soils groupings as seen in the Washington County survey, more accurate assessments of true value for specific parcels of land will be obtained. Despite the difficulties entailed, such an approach is by no means impossible.

2. Grouping Criteria

The major criteria for grouping farmlands are soil characteristics, internal and external drainage, and slope.[93] Within these criteria, there are two points of view from which groupings may rationally be made: (a) income or production history;[94] or (b) management practices and costs necessary to produce a harvestable crop.[95]

3. Establishment of True Value

The true value of the average parcels or tracts of land within each group, under typical management practices, should then be determined from an owner/operator perspective.[96] The underlying assumption is that the owner of the land will be the person farming it and that his income will derive from his own farming efforts on the land. The beginning point and the most important consideration is the natural productive capability of the soils.[97] This point of departure suggests an income or earnings based approach to value which should be figured accordingly: (a) develop the typical crop plan for the typical tracts of land within each soils group over a period of time (three to five years). For example, determine the typical cotton-soybean acreage ratio within each of the soils groups,[98] which, in the case of the better soils, a greater percentage will almost certainly be in cotton. However, a typical crop plan for the poorer soils will show a heavier emphasis on soybeans;[99] (b) ascertain cost data for the typical farming operations on the various soils groups—such data is abundantly available;[100] (c) ascertain average

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[93] R. SUTER, *supra* note 72, at 161-200.

[94] *Id.* at 245-47.

[95] This is the basis for the classification employed in the development of Soil Management Groups by the Mississippi Agricultural and Forestry Experiment Station. S. Herren, *supra* note 10, at 51.

[96] *Id.* at 54-57. For explanations of the use of both approaches, *see* R. SUTER, *supra* note 72, at 249. E. CROUSE & C. EVERETT, *supra* note 22, at 30-32, begins with the rental income approach, primarily on the assumption that higher quality data will be available. Today, 20 years later, owner-operator data is much more abundant. *See generally* R. SUTER, *supra* note 72.

[97] Consent Order, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976) at 2-3.

[98] *See, e.g.*, S. Herren, *supra* note 10, at 65, Table 7.

[99] *Id.*

[100] See Testimony of James H. Simpson, Record, vol. I, at 102-04, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976); Testimony of Robert C. Suter, Record, vol. II at 345-46, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976); *see, e.g.*, Mississippi Agricultural and Forestry Experiment Station, BULL. NO. 834, CROP BUDGETS AND PLANNING DATA FOR MAJOR FARM ENTERPRISES IN THE MISSISSIPPI-LOUISIANA DELTA, 1975 (May 1975); MISSISSIPPI AGRICULTURAL AND FORESTRY EXPERIMENT STATION, BULL. NO. 832, SPECIFIC INPUTS AND PRICES ASSOCIATED WITH SOYBEAN PRODUCTION COSTS FOR THE MISSISSIPPI DELTA, 1975 (Apr. 1975); MISSISSIPPI AGRICULTURAL

yields within each soils group under typical management over a substantial period of time (five to ten years);[101] (d) ascertain the commodity prices for the crops included in the crop plan over a substantial period of time (five to ten years);[102] (e) ascertain the investment capitalization rate,[103] which typically is composed as follows:

(1)	Opportunity cost of money	7%
(2)	Risk factors	2-3%
(3)	Non-liquidity factor/penalty	1-3%
(4)	Management factor	½-1%
	Overall capitalization rate	10-14%[104]

It is then a simple matter to employ this data to "compute" the value of lands within each soils group.[105] The resulting value is an

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AND FORESTRY EXPERIMENT STATION, BULL. No. 832, SPECIFIC INPUTS AND PRICES ASSOCIATED WITH COTTON PRODUCTION COSTS FOR THE MISSISSIPPI DELTA, 1975 (Apr. 1975).

[101] *See, e.g.*, U.S. DEP'T OF AGRICULTURE, SERIES 1958, No. 3, SOIL SURVEY, WASHINGTON COUNTY, MISSISSIPPI 13-14 (May 1961); U.S. DEP'T OF AGRICULTURE, SERIES 1952, No. 5, SOIL SURVEY, SUNFLOWER COUNTY, MISSISSIPPI 11-12 (Feb. 1959).

[102] Commodity prices are published by the various commodity exchanges and are also available in various publications of the Mississippi Agricultural and Forestry Experiment Station. *See, e.g.*, MISSISSIPPI AGRICULTURAL AND FORESTRY EXPERIMENT STATION, BULL. No. 833, SPECIFIC INPUTS AND PRICES FOR FOOD GRAINS, FEED GRAINS AND SILAGE CROPS, MISSISSIPPI DELTA, 1975 (May 1975); MISSISSIPPI AGRICULTURAL AND FORESTRY EXPERIMENT STATION, BULL. No. 831, SPECIFIC INPUTS AND PRICES ASSOCIATED WITH COTTON PRODUCTION COSTS FOR THE MISSISSIPPI DELTA, 1975 (Apr. 1975).

[103] Testimony of James H. Simpson, Record, vol. I, at 93-96, 100-01, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976); Testimony of Robert C. Suter, Record, vol. II, at 324, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976); E. CROUSE & C. EVERETT, *supra* note 22, at 35-38; R. SUTER, *supra* note 72, at 267-71. The most difficult aspect of the approach to value suggested here is determination of the capitalization rate. So long as the same rate is applied to all soils groupings, however, there is exact proportionality and, therefore, equity, even if the capitalization rate selected is open to question. For example, selection of a 10% capitalization rate, as distinguished from an 8% capitalization rate, may produce differences in the values established for each soils group, but Class 6 will still be in the same proportion to Class 1 regardless of which capitalization rate is selected. No inequity in taxation results because the mill rate applied to all assessed values will be the same.

[104] Testimony of James H. Simpson, Record, vol. I, at 93-96, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976). *But see* Testimony of Robert C. Suter, Record, vol. II, at 323-28, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976).

[105] Against the objection certain to be raised that this approach is not feasible, it is noted that it is currently used in several states. Testimony of Robert C. Suter, Record, vol. II, 338-39, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976). *See generally* E. CROUSE & C. EVERETT, *supra* note 22, at 35-38; R. SUTER, *supra* note 72, at 265-89; THE APPRAISAL OF REAL ESTATE, *supra* note 69, at 347-69. Further, this

owner/operator, income capitalization value.[106]

4. Verification of True Value

In order to verify the accuracy and validity of the value thus computed, the process should be repeated using the same crop plan and soils groupings. This time, however, a rental income approach should be used.[107] This approach assumes that the owner does not farm his own land, but instead leases it to others, his income deriving from rentals. Rather than working with yields data, costs and commodity prices, the appraiser looks to what the typical owner, over a substantial period of time, has received in rents.[108] If the data is sound, the valuation ascertained under the rental approach and the owner/operator approach, within each soils group, should be substantially equal. If there should be a substantial variance in any of the values, the approach for which the better quality data[109] is available should be emphasized in establishing the basic value of the land.

Once the income value has been established, numerous adjustments may be in order with reference to particular parcels of land or with reference to subgroups within each soils group. Some of the considerations relevant to such adjustments are location, homesite, markets, roads, transportation, community, hazards, improvements, physical features, natural resources, general efficiency and neighborhood conformity.[110]

After the income based value has been established, a market data analysis should also be performed. This involves a careful analysis of comparable sales for each of the six soils groupings. In this process, the assessor should determine the price which the owner would be willing

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approach has been used in some states for more than two decades. *Id.* at 245-89 (includes an excellent source listing on the income capitalization approach to value). *See also* E. CROUSE & C. EVERETT, *supra* note 22, at 14-15. Finally, the feasibility and utility of the income capitalization approach in both the delta and the hills of Mississippi have been affirmatively demonstrated. S. Herren, *supra* note 10, at 58-81. Access to computer capability, of course, is a *sine qua non*.

[106] This process is explained in S. Herren, *supra* note 10, at 58-81. For the result of such computations, *see id.*

[107] E. CROUSE & C. EVERETT, *supra* note 22, at 31-32.

[108] While the private appraiser may have some difficulty obtaining accurate data regarding rentals, it must be remembered that the county taxing authorities have almost total power to require the owner of all taxable parcels of land within the county to produce any requested information. See MISS. CODE ANN. § 27-35-23 (1972). Therefore, rental income data is accessible to taxing authorities in Mississippi.

[109] See notes 116 through 118 and accompanying text *infra*.

[110] For a detailed explanation of the adjustment process, see E. CROUSE & C. EVERETT, *supra* note 22, at 39-77.

to accept and the price which he would expect to receive for the land if he were disposed to sell it to another, able and willing to buy, each being fully knowledgeable and informed of all facts and circumstances relevant to value and neither acting under compulsion.

The values determined through the market data approach serve two important functions. First, sound economic principles recognize that market forces do affect value. Therefore, the market must be considered before the establishment of value is complete. Additionally, adjustments in the income value may be required to reach true value. Second, market data serves as an additional check on the accuracy of the income value. While market value and income value are not the same, if they differ radically, the assessor should recognize that he has done something wrong.

Because of the importance of an accurate ascertainment of value, a further cross-check should be made by use of the "key farm" method.[111] The tax assessor should select a small percentage—2% or 3%—of all properties including representative samplings of different types of properties. Specific individual appraisals should be performed and the results cross-checked against the value derived from the application of the above technique.[112]

At the conclusion of this process, the tax assessor will have established a value for land in each of the soils groupings. For example, lands in Group 1 may have been assigned a true value of $1,500 per acre, whereas lands in Group 6 may have been assigned true value of $150 per acre.[113]

5. Application of the Value

The next step in the process requires the application of the value to the specific taxable parcels of land within the county. The tools necessary to perform this task include: (a) a detailed soils map of the county;[114] (b) a legal description of the particular tract of land involved

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[111] In the *key farm method,* complete appraisals are made on a group of representative farms in the district being appraised. The group usually includes 2 or 3 percent of all the properties in the district. They are chosen to cover a range of size, type, quality, and location. The values on all other properties are then determined by comparison with the key farms.

Id. at 334.

[112] This process is described in THE APPRAISAL OF REAL ESTATE, *supra* note 69, at 64-72; R. SUTER, *supra* note 72, at 434.

[113] This range of values is quite realistic. See S. Herren, *supra* note 10, at 68, Table 9.

[114] These maps are included in the Soil Survey of the various counties published by the United States Department of Agriculture Soil Conservation Service. *See, e.g.,* U.S. DEP'T OF AGRICULTURE, SERIES 1958, NO. 3, SOIL SURVEY, WASHINGTON COUNTY, MISSISSIPPI

coupled with aerial photographs of the land; (c) an itemization of the technical soils classifications within each soils grouping; and (d) the values established for each soils group. To illustrate the mechanics of this process, consider the following example. A taxpayer owns thirty acres of land in the northwest quarter of Section 18, Township 16 North, Range 3 West in a particular county. After the tract of land is identified according to its legal description on the county soils map, the various soils types in the thirty acre tract are then identified. Fourteen different soils types are found. They are then checked against the soils groupings which have been made as suggested above. It is found that the fourteen types fall into only three of the six soils groups. The thirty acre tract consists of fifteen acres of Group 2 soils, twelve acres of Group 3 soils and three acres of Group 5 soils. The true value/assessed value[115] of this parcel of land would thus be computed as follows:

15 acres	$800 per acre	$12,000
12 acres	$600 per acre	$ 7,200
3 acres	$400 per acre	$ 1,200
Total True Value/Assessed Value		$20,400

If the process is done correctly, the value established should never vary more than 10% from the value which would be established in an independent, individualized appraisal of the particular tract of land.

E. Summary Considerations on True Value

The preceding discussion relates to the valuation of cultivatable agricultural lands. It is important to bear in mind, however, that this income based approach to value does not work nearly so well, if at all, with other types of taxable real property. Residential property,[116] for example, generates no income as a general rule. Consequently, the better basis for valuation of residential real estate is the cost approach, *i.e.* reproduction cost less depreciation. Generally, market data is plentiful and, as always, should be used as a backup referrent. A shopping center, on the other hand, may be valued on a combined utilization of the income approach and the cost approach.[117] In this context, it is unlikely

(May 1961); U.S. Dep't of Agriculture, Series 1952, No. 5, Soil Survey, Sunflower County, Mississippi (Feb. 1959).

[115] *See* R. Suter, *supra* note 72, at 444-49, in which it is stressed that fractional assessments pose much greater problems in an ad valorem tax context than do full assessments equaling the true value of the property being assessed.

[116] For a discussion of the valuation process for residential properties, see Assessing and the Appraisal Process, *supra* note 75, at 21-23.

[117] *See* American Nat'l Ins. Co. v. Board of Supervisors, 303 So. 2d 457, 459 (Miss.

that much comparable sales data will be available with which to perform a market data analysis. Indeed, with large shopping centers or manufacturing plants, there may be so little market data available that this approach should be ignored entirely. In other words, for each category of property on the tax rolls, differing approaches should be used. The choice of the particular valuation methods to be used should, however, always depend upon (1) the reasons why the typical person holds the property and (2) the appoaches that yield the higher quality data.[118]

One of the benefits of a flexibly worded definitional assessment statute, such as Mississippi's statute, is that it permits utilization of the approach to value best suited to the type of property being valued. Nevertheless, it does have its shortcomings. The current statutory language in section 27-35-49, standing alone, is not exactly the firm foundation that an equitable and economically sound ad valorem tax system needs. Therefore, as proposed hereinafter, the true value statute should either be (1) amended by the legislature, (2) altered by the state supreme court in accord with the above criteria[119] or (3) given a more equitably functional interpretation by the State Tax Commission through administrative regulation to incorporate the above enunciated principles.

II. The Constitutional Requirement of Uniformity and Equality in Ad Valorem Taxation

In the preceding pages, the primary focus has been upon the determination of value. This section will address the problems of equality and uniformity once the assessed value of taxable property has been determined. Of course, if all properties were assigned an assessed value equal to their full true value, equality would follow as a matter of course.

1974) (five factors used in valuing shopping center property to arrive at true value are acceptable if used uniformly in valuing all similar property).

[118] See Assessing and the Appraisal Process, *supra* note 75, at 5.

[119] An excellent example of the type of judicial construction suggested was evidenced recently in Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976). The Sunflower County litigation was primarily concerned with rural agricultural lands. The economic approach to value developed in *Davidson,* however, is also applicable in other contexts, *e.g.,* commercial real estate and residential property valuation. The circuit court defined value in the following manner:

> [T]he true value of rural agricultural lands will be ascertained . . . by reference to
>
> (i) The income capitalization approach to value, specifically including the natural productive capability of the soils, and
>
> (ii) The market data approach to value, and
>
> (iii) All other factors, the consideration of which is required by Section 27-35-49 as aforesaid.

Id. at 2-3.

Unfortunately, this optimum practice has not been adopted on a widespread basis.

The mandate of equality in property assessment and taxation is derived from the Constitution of the United States[120] and the Constitution of the State of Mississippi.[121] The United States Constitution, through the equal protection clause of the fourteenth amendment, commands that no state shall deny to any person within its jurisdiction the equal protection of the law, thereby compelling each state to ensure equality in the treatment of its taxpayers.[122] In addition, the equal protection strictures impose a minimum standard of uniformity to which state legislative bodies must adhere.[123] This federal constitutional standard of equality is imposed independently of any state equality and uniformity provisions.[124] Accordingly, the constitutional and legislative directives of any state must first meet the federal standards.[125]

A. State Property Taxation Under the Equal Protection Clause

The United States Supreme Court's first attempt to delineate the fourteenth amendment standards in the context of ad valorem taxation came in 1918. In *Sunday Lake Iron Co. v. Township of Wakefield,*[126] the taxpayer challenged the action of the State Board of Tax Assessors in assessing its property at full value, thereby substantially increasing the valuation placed on the property.[127] Although the board action apparently imposed an assessed value higher than the assessed value of the other lands in the county, the Court rejected the equal protection argument because of an absence of "any purpose or design to discriminate"[128] and emphasized further that the good faith of the taxing officers must

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[120] U.S. CONST. amend. XIV.

[121] MISS. CONST. art. 4, § 112. See note 88 *supra.* This provision is commonly referred to as the "uniformity and equality clause." In addition, MISS. CONST. art. 7, § 181 provides: "The property of all private corporations for pecuniary gain *shall* be taxed in the same way and to the same extent as the property of individuals . . . ." (emphasis added).

[122] Southland Mall, Inc. v. Garner, 455 F.2d 887, 889-91 (6th Cir. 1972); Weissinger v. Boswell, 330 F. Supp. 615, 621-24 (M.D. Ala. 1971); Ingalls Iron Works Co. v. Chilivis, 228 S.E.2d 866, 869 (Ga. 1976), *appeal dismissed*, 45 U.S.L.W. 3569 (U.S. Feb. 22, 1977) (No. 76-734); City of Malden v. Appellate Tax Bd., 326 N.E.2d 342, 346-47 (Mass. 1975); Dartmouth Corp. of Alpha Delta v. Town of Hanover, 115 N.H. 26, 332 A.2d 390, 392 (1975); Snow v. City of Memphis, 527 S.W.2d 55, 64-66 (Tenn. 1975).

[123] W. NEWHOUSE, *supra* note 1, at 601.

[124] The great majority of these states have adopted "uniformity and equality" clauses in their efforts to protect the interests of all taxpayers. *Id.* at 771-815.

[125] See *id.* at 601.

[126] 247 U.S. 350 (1918).

[127] *Id.* at 351-52.

[128] *Id.* at 353.

be presumed.[129] In rejecting the constitutional attack, however, the Court reviewed the parameters of the fourteenth amendment protection.

> The purpose of the equal protection clause of the Fourteenth Amendment is to secure every person within the state's jurisdiction against intentional and arbitrary discrimination, whether occasioned by express terms of a statute or by its improper execution through duly constituted agents. And it must be regarded as settled that intentional systematic undervaluation by state officials of other taxable property in the same class contravenes the constitutional right of one taxed upon the full value of his property . . . .[130]

The constitutional primacy of the fourteenth amendment's requirement of equal treatment of property owners for ad valorem tax purposes was again recognized in *Sioux City Bridge Co. v. Dakota County*.[131] The taxpayers in *Sioux City* owned property that had been assessed at 100% of its true value. However, all other real estate and improvements in the county were assessed at approximately 50% of their true value.[132] Despite its failure to reach the merits of the equal protection claim, the Court reiterated the importance of equal protection compliance:

> Where it is impossible to secure both the standard of the true value, and the uniformity and equality required by law, the latter requirement is to be preferred as the just and ultimate purpose of the law.[133]

The constitutional protection accorded a taxpayer discriminatorily taxed was again confronted in *Township of Hillsborough v. Cromwell*.[134] In *Hillsborough*, the Court upheld a district court decision invalidating a property assessment on state law grounds.[135] While recognizing the power of a federal court to decide an issue on the basis of local law, without reaching the constitutional question,[136] the Court deemed it important to review the fourteenth amendment protections.

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[129] *Id.*

[130] *Id.* at 352-53.

[131] 260 U.S. 441 (1923).

[132] *Id.* at 445.

[133] *Id.* at 446. The Court in *Sioux City* also enunciated the standard of relief due the taxpayer when his property is assessed at 100% of true value and other similar property is intentionally valued at a lower percentage of true value.

> The right of the taxpayer whose property alone is taxed at 100 percent of its true value *is to have his assessment reduced to the percentage* of that *value* at *which others are taxed,* even though this is a departure from the requirement of the statute [that all property be taxed at true value].

Id. (emphasis added).

[134] 326 U.S. 620 (1946).

[135] *Id.* at 620-29.

[136] *Id.* at 629.

> The equal protection clause of the Fourteenth Amendment protects the individual from state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class. The right is the right to equal treatment.[137]

The cases decided in this era struggled with and refined the elements necessary to establish the traditional equal protection violation—"intentional and arbitrary discrimination."[138] The good faith presumption accorded the actions of the taxing authorities, particularly in *Wakefield*,[139] was a major factor considered and modified in the course of subsequent judicial interpretation. In *Cumberland Coal Co. v. Board of Revision of Tax Assessments*,[140] for example, the Pennsylvania County Commissioners in Cumberland County valued all coal lands in the county at the uniform rate of 50% of the property's actual value. In addition, all coal-producing property within each township was assigned a uniform value per acre.[141] In arriving at the uniform value in each township, however, the Commissioner totally ignored such factors as proximity to transportation, accessibility of the coal to a market and costs, which admittedly affected actual value.[142] The Court held that this was a fatal error and emphasized that simply because the assessing officials believed their conduct to be valid would not render it less vulnerable to attack as discriminatory.[143] Further, the guiding principle underlying the finding of intentional and arbitrary discrimination was recognized by the Court's conclusion that the discriminatory assessments did not result from "mere errors in judgment" but "were made pursuant to a deliberately adopted system."[144]

In light of the Supreme Court's pronouncements, it can be presumed that a taxpayer is entitled to relief if he proves that his property was assigned an assessed value substantially higher than similar proper-

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[137] *Id.* at 623.

[138] Taxpayers generally have sustained the burden of establishing equal protection claims by showing that: (1) their property is assessed at true value while other property in the same class is undervalued, *see, e.g.*, Sioux City Bridge Co. v. Dakota County, 260 U.S. 441, 443-44 (1923); (2) although their property was assessed at the same level as other properties, the taxing authorities chose to ignore clear differences in value, *see, e.g.*, Cumberland Coal Co. v. Board of Revision, 284 U.S. 23, 25-26 (1931); or (3) the taxing authorities ignored relevant valuation factors consistently used in similar situations or where the appraisal practice was clearly settled, *see, e.g.*, Southland Mall, Inc., v. Garner, 455 F.2d 887, 891 (6th Cir. 1972).

[139] The Court characterized the tax assessment as a "proceeding in entire good faith" by an "inexperienced local assessor." 247 U.S. at 352.

[140] 284 U.S. 23 (1931).

[141] *Id.* at 26.

[142] *Id.* at 29-30.

[143] *Id.* at 25.

[144] *Id.*

ties.[145] The fact that the tax assessor, in good faith, believes that a correct assessment has been made will not be an obstacle to obtaining proper relief in the form of a decrease in the assessed value of the taxpayer's property or an increase in the assessed value of similar properties of other taxpayers until they are equal to the property being discriminatorily assessed.[146]

B. Uniformity and Equality Under the Mississippi Constitution

The Mississippi Constitution explicitly provides for the equal treatment of all taxpayers within the state.

> Taxation shall be uniform and equal throughout the state. Property shall be taxed in proportion to its value. Property shall be assessed for taxes under general laws, and by uniform rules, and in proportion to its value.[147]

This is commonly referred to as the "uniformity and equality" clause, clearly providing for the equal protection of the state's taxpayers in the apportionment of the tax burden.[148] In the present context, this provision has a twofold application. First, for example, as applied to the assessment ratio, it means that if *A*'s rural cultivatable property is assessed and taxed on the basis of a valuation which is at 50% of its true value in county *X*, and *B*'s rural cultivatable property is assessed and taxed at 30% of its true value in the same county, then *A* is entitled to judicial relief since his property is assessed at a substantially higher percentage of its true value than is *B*'s. Otherwise, *A* would be required to bear an inequitable share of the tax burden. Likewise, if *A* owned rural cultivatable property in county *X* and *B* owned the same type of property in county *Z*, and the same percentage ratios were applied as above, the inequitable burden borne by *A* would be identical. This assumes the state takes a certain, equal portion of the property tax dollar from each county in the state, as is done in Mississippi.[149]

Secondly, a violation of the uniformity and equality clause occurs when the same general classes of property are arbitrarily assigned the same "true values" when, in reality, patent differences in their values exist. This is, unfortunately, the approach to "equalization" in many counties in Mississippi.[150] These counties essentially proceed on the

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[145] *See, e.g.*, Sioux City Bridge Co. v. Dakota County, 260 U.S. 441 (1923).

[146] *See* note 122 *supra*.

[147] MISS. CONST. art. 4, § 112.

[148] *See generally* W. NEWHOUSE, *supra* note 1.

[149] MISS. CODE ANN. § 27-39-1 (Supp. 1976) ("A state ad valorem tax of four (4) mills on the dollar . . . is hereby levied on all taxable property in the State of Mississippi.").

[150] See, *e.g.*, Alcorn, Amite, Clarke, Covington, Forrest, Franklin, George, Hancock,

premise that all general classes of property are to be assigned an arbitrary "true value." The assessment ratio is then applied to the "true value" figure, yielding a per acre assessed value. For example, one county may arbitrarily assign a "true value" of $200 to all open, rural cultivatable property within its boundaries. The county's 25% assessment ratio is then applied to this figure, yielding a $50 per acre assessed value. The tax discrimination inevitably flows from the county's nonrecognition of different qualities of cultivatable, agricultural property. The discrimination is more clearly seen by reference to a schematic chart:[151]

Land Class	True Value Per Acre	Leflore County's "True Value" Per Acre	Assessment Ratio	Assessed Value Per Acre	True Assessment Ratio
Worst, Class 3 Lands	$300	$200	27.5%	$55	18.33%
Best, Class 1 Lands	$1,000	$200	27.5%	$55	5.50%

This chart clearly shows that the worst lands carry more than three times their proportional share of the tax burden than do the best lands in the same county.

The Sunflower County property assessment scheme used in 1974 presented a less visible, but equally inequitable, form of discrimination in the taxation of open, rural cultivatable property.[152] Rather than valuing all farmlands at the same per acre figure, Sunflower County established three general classes of property which were arbitrarily assigned "true values" in accordance with the category in which each was placed. The assigned values ranged from $275 per acre for the worst class of open, rural cultivatable property, to $375 per acre for the best class of such property in the county.[153] The true range of values between these

Issaquena, Itawamba, Jefferson, Jefferson Davis, Jones, Kemper, Lamar, Leflore, Lowndes, Monroe, Montgomery, Panola, Rankin, Scott, Simpson, Tate, Tishomingo, Webster and Wilkinson. Stipulation in Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976).

[151] Letter from Willis B. Brumfield, Chancery Clerk, Leflore County, Mississippi, to H. Dixon Montague (Feb. 23, 1977) (on file with the *Mississippi Law Journal*).

[152] It was this assessment scheme that spawned the Sunflower County equalization litigation. *See* Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976).

[153] *See id.* Exhibit P-2 (Rural Land Values Chart of Sunflower County, Mississippi).

classes of property, however, was actually more than $700 per acre.[154] The assessed value was then determined by applying a 12% assessment ratio to the "true value" of the class of property determined by the rural land values chart. The discrimination inherent in the scheme can be clearly seen through the chart below.[155]

Land Class	True Value Per Acre	"True Value" Per Acre Per Rural Land Values	Assessment Ratio Per Rural Land Values	Assessed Value Per Acre	True Assessment Ratio
Worst, Class 3 Lands	$300	$275	12%	$33	11%
Best, Class 1 Lands	$1,000	$375	12%	$45	4.5%

It is obvious that the worst class lands were again carrying nearly three times more of their proportional share of the tax burden than the best class lands.

The special case of Mississippi's public utilities further evidences a case of gross assessment ratio discrimination. The valuation of public utility property for ad valorem tax purposes is carried out by the State Tax Commission,[156] which has arbitrarily adopted a 30% assessment ratio.[157] However, when compared to assessment ratios applied to similar property in the various counties throughout the state, a gross disparity exists,[158] clearly violating the uniformity and equality clause. A lawsuit by any one of the public utilities would inevitably result in a total

[154] See Testimony of Wade Wineman, Record, vol. III, at 61-62, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976).

[155] Testimony of Coftan A. Davidson, Record, vol. II, at 239-44, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976). *See also* Testimony of James H. Simpson, Record, vol. I, at 119-22, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976).

[156] MISS. CODE ANN. § 27-35-301 (1972).

[157] HOUSE WAYS & MEANS COMM., STUDY OF PROPERTY TAXATION, INTERIM COMM., MISS. LEGISLATURE (1973); J. Grace, *supra* note 10, at 19. This assessment is clearly contrary to statutory law. *See* MISS. CODE ANN. § 23-35-301 (1972), which provides in pertinent part:

> The members of the state tax commission . . . shall . . . assess the property of [all public service corporations] affixing its true value so that such property shall bear its just proportion of taxation . . . .

[158] For example, Forrest County purports to apply a 15% assessment ratio on improved commercial and industrial real estate. Nevertheless, the assessed value of properties owned by public utilities is 30% of true value. Affidavit of Adelaide C. Smith, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976).

reformulation of the assessment ratio applied to commercial and industrial real estate within each county.

Although there have been no definitive ratio assessment cases decided by the Mississippi Supreme Court, its decision in *Knox v. Southern Paper Co.*[159] makes it quite clear that the equality and uniformity clause provides a viable means of protection to the state's taxpayers. *Southern Paper* is an important equalization case in Mississippi for several reasons. First, the case confronted the tension between the requirement that property be assessed at its true (full) value and the requirement that the assessment be uniform and equal with other properties. Following the lead of the Supreme Court of the United States,[160] the court in *Southern Paper* held that the requirements of the uniformity and equality clause are paramount,[161] especially when viewed in light of the equal protection clause of the fourteenth amendment.[162]

A month later, the court decided *Edward Hines Yellow Pine Trustees v. Knox.*[163] There the taxpayer charged that the assessing authorities were attempting to assess his property "at 100% of its value, while othe taxpayers of the county and of other counties of the state [were] assessed at only 60% of the value of their property."[164] Although the case was decided on procedural grounds,[165] the court did construe the uniformity and equality clause to mean that

> [a] fair and proper legal assessment of appellants' property would be such assessment as would place its value upon a fair, equal and uniform basis with that of other property of like character and value throughout the county and state.[166]

The court also acknowledged that the alleged discrimination, if proved, would violate the equality and uniformity provisions of both the Mississippi and United States constitutions.[167]

The most recent application of the uniformity and equality clause by the state supreme court came in *American National Insurance Co. v. Board of Supervisors.*[168] As in the *Southern Paper* and *Hines* cases,

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[159] 143 Miss. 870, 108 So. 288 (1926).

[160] Sunday Lake Iron Co. v. Town of Wakefield, 247 U.S. 350 (1918).

[161] 143 Miss. at 879, 108 So. at 289-90.

[162] *Id.*, 108 So. at 290.

[163] 144 Miss. 560, 108 So. 907 (1926).

[164] *Id.* at 571, 108 So. at 911.

[165] *Id.* The Supreme Court's decision in *Hines* is an inflexible construction of state remedies available to the taxpayer. For the aftermath of this case, which raises questions beyond the scope of this article, see Edward Hines Yellow Pine Trustees v. Stewart, 46 F.2d 910 (5th Cir. 1931).

[166] 144 Miss. at 572, 108 So. at 911.

[167] *Id.*

[168] 303 So. 2d 457 (Miss. 1974).

the court recognized the importance and applicability of both the state and federal constitutions:

> Of the several requirements of the [Mississippi] Constitution, uniformity and equality are paramount. And in order to assure uniformity and equality so that every taxpayer shall bear his fair share of the tax burden, the Constitution provides that property shall be assessed by uniform rules and in proportion to its value. The equal protection clause of the Fourteenth Amendment to the Constitution of the United States also requires uniformity and equality in taxation.[169]

Interestingly, *American National* was not just another assessment ratio discrimination case. The court found that the taxpayer's shopping mall had been valued on a combined consideration of cost, income, replacement cost, insurance coverage and other intangible values.[170] On the other hand, the court found that the general rule for assessing improved real estate in Harrison County was to utilize a cost per square foot basis only.[171] Since "[a]t least five other factors were considered,"[172] the assessment levied against the taxpayer's property was struck down, because other similar taxpayers in the county did not have their property valued under the same criteria.

> The Constitution requires uniform rules in the assessment of property and such rules must be capable of being used as a yardstick to determine whether one taxpayer is being taxed equally with other taxpayers.[173]

Within general classes of property, this holding is both wise and correct. It is hoped, however, that no one will suggest that the same approach to value should be used across property classes. As previously indicated,[174] income-producing capacity is a critically important consideration with agricultural property and with commercial property. In the case of residential property, however, there is no income-producing capacity. By the same token, the cost approach is very important in valuing commercial property or residential property. With agricultural property, however, there is no cost basis. The distinctions are important.

It is thus evident that the county tax assessor is somewhat constricted in assessing property for ad valorem tax purposes. Essentially, the only leeway that he is given is in assigning a "true value" to taxable property within the county. His "true value" assessments cannot be

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[169] *Id.* at 459.
[170] *Id.*
[171] *Id.* at 460.
[172] *Id.*
[173] *Id.*
[174] *See* section I. *C. supra.*

palpably arbitrary. They must reflect a logical, equitable arrival at true value based upon the types of approaches enumerated above.[175] It is in this regard that the tax assessor is given a free hand in valuation. Thus, it is strongly urged that the Supreme Court of Mississippi make it clear that, within the scope of the uniformity and equality clause, the assessing authorities are free to determine true value on a combined consideration of the reason why a typical person acquires and holds the property of a certain class and the approaches to value for which the most accurate data are available.[176]

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[175] For example, the classification of property and the taxing of only an arbitrary percentage of the "true value" of the property based upon the classification is constitutionally disallowed when not specifically provided by a state's constitutional or statutory law. In Louisville & N.R.R. v. Public Serv. Comm'n, 249 F. Supp. 894, 899 (M.D. Tenn. 1966), *aff'd*, 389 F.2d 247 (6th Cir. 1968), the court concluded that

> the Fourteenth Amendment commands equality of treatment unless the state has established different and reasonable classes of property. In the absence of classification by the state, there is no federal classification which would permit different tax treatment for [property].

Even if classification of property is utilized by the taxing authorities, it is nevertheless violative of both the state and federal constitutions if the classification is patently discriminatory, both among classes and within a class.

> [T]here is a point beyond which the State cannot go without violating the Equal Protection Clause. The State must proceed upon a rational basis and may not resort to a classification that is palpably arbitrary.

Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 527 (1959); *accord,* Cumberland Coal Co. v. Board of Revision, 284 U.S. 23 (1931):

> It is established that the intentional, systematic under-valuation by state officials of taxable property of the same class belonging to other owners contravenes the constitutional right of one taxed upon the full value of his property.

Id. at 28; Southland Mall, Inc. v. Garner, 455 F.2d 887, 889 (6th Cir. 1972) (An equal protection violation exists either when a "[taxpayer's] property [is] assessed at its true value while other property [is] intentionally undervalued" or when "property [is] assessed at the same level as other properties because the taxing authorities intentionally chose to ignore clear differences in value . . . ."); Weissinger v. Boswell, 330 F. Supp. 615 (M.D. Ala. 1971):

> It is well established that the states have wide discretion in the laying and collecting of their taxes. The law is equally clear, however, that such discretion cannot be exercised so as to arbitrarily deprive persons of their constitutional rights.

Id. at 621; Dartmouth Corp. of Alpha Delta v. Town of Hanover, 332 A.2d 390, 392 (N.H. 1975) (violation of equal protection clause to assess some property in same class at true value, while other property in such class assessed at less than true value); Snow v. City of Memphis, 527 S.W.2d 55, 64-66 (Tenn. 1975) (if property taxes are arbitrarily imposed, they are violative of the equal protection clause).

Against this background, the county tax assessors throughout Mississippi persist in determining the ad valorem tax on the basis of an arbitrarily formulated percentage of the "true value" of the property, *e.g.,* commercial property, 15%; open, rural cultivatable property, 12%; residential property, 10%; having no reasonable, fair and substantial relation to the law under which the tax assessors operate.

[176] The courts in other states have consistently taken the lead in enforcing their

III. INTERCOUNTY EQUALIZATION

The preceding discussion of equalization was essentially confined to the intracounty equalization issue. It concerned the lack of uniformity and equality that exists in both the assessment of property at less than its realistic true value, as well as the arbitrary application of varying percentages to the purported "true value" of property. This section's primary focus is upon the lack of uniformity and equality that exists among the counties in the imposition of the ad valorem tax burden. These disparities may occur regardless of whether there is uniformity and equality within a particular county, assuming the state takes a uniform amount of the ad valorem tax dollar from each county, as is done in Mississippi.[177] Thus, as in intracounty assessment, the violation of the uniformity and equality clause in intercounty assessment can basically take two forms: (1) through the incorrect arrival at true value, and, even assuming that true value has been correctly figured, (2) through varying assessment ratios from county to county regarding the same type of property. As illustrated below, the gross disparity in assessment among the counties is obvious.

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uniformity and equality clause in the absence of definitive legislative action. *E.g.*, City of Malden v. Appellate Tax Bd., 326 N.E.2d 342, 346 (Mass. 1975) (arbitrarily applied percentages to "full cash value" of taxable property violative of equal protection clause if the percentages were not based on logical and reasonable grounds); Ploetz v. County of Hennepin, 301 Minn. 410, 223 N.W.2d 761, 763 (1974) (per curiam), *quoting* Hamm v. State, 225 Minn. 64, 70, 95 N.W.2d 649, 654 (1959) (" 'Uniformity [does not] permit the adoption of an arbitrary yardstick of valuation for all properties which ignores their differences in actual market value.' "); Paras v. City of Portsmouth, 115 N.H. 63, 335 A.2d 304, 307-08 (1975) (in appraising property at its true value, court allowed utilization of the cost approach, income-producing approach, comparable sales approach and "other relevant factors to property value"); Switz v. Township of Middletown, 23 N.J. 580, 130 A.2d 15, 23 (1957) ("[T]he market value is evidential but not the exclusive criterion [of full true value] . . . . Special circumstances 'may increase or depress market value without affecting true value or vice versa.' ") (citation omitted); Board of Educ. v. Fulton County Budget Comm'n, 41 Ohio St. 2d 147, 324 N.E.2d 566, 567 (1975) (per curiam), *quoting* State *ex rel.* Park Inv. Co. v. Board of Tax Appeals, 175 Ohio St. 410, 413, 195 N.E. 908, 910 (1964) ("[T]he 'assessed value' of real property . . . 'must be relatively uniform not only throughout the state but also as to various classes of real property.' "); Lunkenheimer Co. v. Board of Revision, 41 Ohio App. 2d 27, 322 N.E.2d 133, 136 (1974) (court enforced the uniformity and equality clause requiring every county's tax assessment to be unvarying throughout the state); Valley Forge Golf Club v. Board for the Assessment & Revision of Taxes, 3 Pa. Commw. Ct. 644, 285 A.2d 213, 216 (1971) (where tax assessor taxed some property at actual value and other property at less than actual value, tax assessor forced to make all taxes uniform); Snow v. City of Memphis, 527 S.W.2d 55, 64-66 (Tenn. 1975) (state constitution must specifically provide a reasonable basis for classifying property). *See generally* W. NEWHOUSE, *supra* note 1; *Nineteenth Annual Survey of Developments in Virginia Law: 1973-1974*, *supra* note 7; Comment, *Equality in Taxation—Houston's Constitutional Dilemma*, 10 HOUS. L. REV. 656 (1973); Note, *supra* note 7.

[177] MISS. CODE ANN. § 27-39-1 (Supp. 1976) ("A state ad valorem tax of four (4) mills on the dollar . . . is hereby levied on all taxable property in the State of Mississippi.").

	True Value Rural Cultivated Property	Assessed Value	Ratio	Mill Rate	Tax
Taxpayer A (County X)	$100,000	$12,000	12%	4	$48
Taxpayer B (County Z)	$100,000	$4,000	4%	4	$16

In the above illustration, the taxpayer in County *X* would perforce be required to pay three times the tax paid by the taxpayer in County *Z* on property of equal value. In fact, the taxpayer in County *X* would be paying a larger share of the state tax than would the taxpayers in any county having an assessment ratio of less than 12% on property of equal value.

Major intercounty equalization litigation has recently come to the forefront in two of Mississippi's neighboring states.[178] In this litigation, the tax assessors in the respective states were found to be acting in defiance of the equal protection clause and, ultimately, were compelled to restructure their system of ad valorem taxation under court order. Mississippi would be wise to evaluate its situation in light of the outcome in these states.

The uniformity and equality rule in Alabama[179] has been consistently interpreted by the Alabama Supreme Court to require "uniformity and equality among all taxpayers, 'private corporations, associations and individuals alike,' both as to ratio and percentage of taxation and also as to rate of taxation."[180] In *Weissinger v. Boswell*,[181] a special three judge court considered alleged violations of both the equal protection clause of the fourteenth amendment and the uniformity and equality provisions of the Alabama Constitution. The facts before the court were

> [t]hat the median ratios for the individual counties in the State of Alabama ranged from lows of 6.7 and 7.0 percent of fair market value in rural Hale and Washington Counties to highs of 23.1 and 26.8 percent of fair market value in urban Madison and Jefferson counties . . . . [T]he median assessment ratio for the state [was] approximately 16.9 percent of fair market value.[182]

[178] *E.g.*, Weissinger v. Boswell, 330 F. Supp. 615 (M.D. Ala. 1971); Board of Educ. v. Fulton County Budget Comm'n, 41 Ohio St. 2d 147, 324 N.E.2d 566 (1975); Snow v. City of Memphis, 527 S.W.2d 55 (Tenn. 1975).

[179] ALA. CONST. art. XI, §§ 211, 217.

[180] State v. Alabama Power Co., 254 Ala. 327, 48 So. 2d 445, 452 (1950).

[181] 330 F. Supp. 615 (M.D. Ala. 1971).

[182] *Id.* at 621.

The court found these variances violative of both the federal and state constitutions, holding that

> any substantial disparity or differences in taxation resulting from the failure of state officers to properly administer the state's tax laws will offend the Due Process and Equal Protection clauses of the Fourteenth Amendment.[183]

Louisville & Nashville R.R. Co. v. Public Service Commission[184] arose in the context of a Tennessee statute requiring assessment of all property at "actual cash value,"[185] and a constitutional proviso that "taxes shall be equal and uniform throughout the state."[186] The taxpayer's property actually was being assessed at 55% to 65% of its value, while all other property in the state was assessed at an average of approximately 30% of its value. The court held this variance in the assessment ratio discriminatory and in violation not only of the Tennessee statutes and constitution, but also the equal protection clause of the fourteenth amendment.[187] Of particular interest in the case was the wide variation in the county assessment ratios then prevailing in Tennessee.[188] These variances were akin to those found in the *Weissinger* case,[189] as well as the assessment ratio variances presently found in Mississippi.[190] In the *Louisville & Nashville* case, the district court considered only the complaint of the railroad that its assessment ratio exceeded the statewide average. There is little doubt, however, that if a classwide assault on the assessment ratio variances had been mounted it would have been successful.[191] The court seemingly sensed this when it commented:

> The Court is aware of the impact of the present decision upon the tax structure of the state and its subdivisions, since the type of discriminatory treatment here involved is deep-seated and of long-standing and many governmental programs have been patterned accordingly.[192]

While the answer is still in doubt, several efforts have been made in recent years to determine the various assessment ratios employed in

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[183] *Id.* at 622.

[184] 249 F. Supp. 894 (M.D. Tenn. 1966), *aff'd*, 389 F.2d 247 (6th Cir. 1968).

[185] 249 F. Supp. at 905, *citing* TENN. CODE ANN. § 67-605 (1955) (current version at TENN. CODE ANN. § 67-606 (1968)).

[186] 249 F. Supp. at 904-05, *quoting* TENN. CONST. art. 2, § 28 (amended 1972).

[187] 249 F. Supp. at 897-99.

[188] *Id.* at 908-10.

[189] 330 F. Supp. at 621.

[190] *See* section II. *B. supra.*

[191] 249 F. Supp. at 908-10.

[192] *Id.* at 904.

Mississippi.[193] Studies of the problems inherent in the existing ad valorem taxation system have numerous deficiencies, however, and have met with only limited success. While each effort has yielded "evidence" of wide variations in assessment ratios from county to county, the studies are inconclusive.[194]

IV. Where Do We Go From Here?

There is no doubt that rampant illegality is prevalent in Mississippi's system of ad valorem property taxation. Reform is direly needed. And in making the reforms, there is a great need for wisdom and insight in all facets of the state and local governments. It will take nothing short of a total commitment on the part of all three branches of state government to correct the existing deficiencies in the ad valorem tax system. Additionally, vertical cooperation among the county tax assessors, the county boards of supervisors, and the State Tax Commission must become a reality for the system to become workable. None of these subdivisions of the government, however, is justified in waiting on the other.

The legislature should, first, push for a definitive supplementation of the present assessment statute. It should carefully delineate the factors and considerations that should be taken into account by the county tax assessor in ascertaining true value.[195] Specifically, it should provide that in valuing property, true value should be determined by reference to a combined consideration of (a) the reasons why the typical person acquired or holds property of the type being valued and (b) the valuation approaches for which the most accurate data is available, provided that at least two approaches be considered when computing true value. Secondly, the legislature should eliminate fractional assessments—assessed value should always equal true value.[195.1] This would

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[193] *See* section I. *supra.*

[194] Although the recent studies have been extremely helpful in revealing the gross disparity and inequality that exists in the present assessed values throughout Mississippi's 82 counties, they have offered little constructive advice upon which to structure a workable and equitable assessment system. *See, e.g.,* D. McKinney & P. Lowry, *supra* note 1; J. Grace, *supra* note 10; Mississippi Economic Council, County Assessment Practices (1971).

[195] If a reappraisal bill should become law, hopefully it would contain a requirement that the assessed value of each parcel of property be individually reexamined at least once every three years. Ideally, of course, this should be done each year. But with thousands of parcels of land on the tax rolls in each county, annual revaluation is impractical.

[195.1] *See* Hellerstein v. Assessor of Islip, 37 N.Y.2d 1, 371 N.Y.S.2d 388, 398-99 (1975) (struck down fractional assessment although it had been a longstanding practice for many years); Town of Sudbury v. Commissioner of Corps. & Taxation, 321 N.E.2d 641, 646-47 (Mass. 1974) (state tax commission has power to direct local tax assessors to take such action as will tend to produce uniformity in valuation and assessment regarding, *inter alia*, fractional assessments). *But see* H. Aaron, *Some Observations on Property Tax*

partially alleviate some of the complications of a too complicated taxation system. Thirdly, the legislature should diligently strive for the enactment of legislation providing for the upgrading of the qualifications of one running for the position of county tax assessor. At a minimum, the legislature should require that, beginning with the 1979 elections, no person may be eligible to seek the office of county tax assessor who is not a licensed real estate appraiser. The present process makes about as much sense as having judges who are not lawyers.[196] Finally, appropriations should be made in order to adequately fund an increased number of qualified staff personnel at all levels—from the Ad Valorem and Equalization Divisions of the State Tax Commission to each county tax assessor's office.[197]

The executive branch, and more specifically, the State Tax Commission, must play an equally active role in revamping the existing taxation system. The power to do so is there. Section 27-35-113 grants the Commission the power

> to compare the assessed valuation of the various classes of property in the respective counties, to investigate and determine if the assessed valuation of any classes of property in any one or more counties of the state is not equal and uniform with the assessed values fixed upon the same classes of property in other counties of the state, and to ascertain if any class of property in any one or more counties is assessed for less than the true value of the property.[198]

If the assessment value is not equal and uniform, "[t]he commission shall have authority to adjust and equalize the same and to require property to be assessed generally at its true value . . . ."[199] Thus, the State Tax Commission's power to review the valuation of property in each county and the power to compel equal valuation among the counties as well as within each county already essentially gives the Commission the authority to revamp the present ad valorem taxation system in line with the suggestions in this article. Therefore, if the legislature fails to act more definitively, the State Tax Commission surely has the statutory authority to make the needed refinements in the definition of true

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Valuation and the Significance of Full Value Assessment, in THE PROPERTY TAX AND ITS ADMINISTRATION, *supra* note 7, at 156.

[196] *See generally* MISS. CODE ANN. § 9-11-3 (1972) (recognizes that one who is not a lawyer may nevertheless be a justice court justice).

[197] The legislature should provide the State Tax Commission with adequate funds to assist counties, on an interim basis, in updating and reforming their systems of valuation. Such funding would greatly contribute to necessary changes in the valuation procedures presently being used throughout the 82 Mississippi counties.

[198] MISS. CODE ANN. § 27-35-113 (1972).

[199] *Id.*; see *id.* § 27-35-115.

value.[200] It is realized, however, as a practical matter, that the State Tax Commission has neither the staff nor the wherewithal to mount an enforcement campaign commensurate with the commands of section 27-35-113. However, if given the appropriations to hire a staff of experts,[201] trained in the area of property appraisal, then the above statutory law would have more than a nominal effect. It would play an active role in ensuring uniformity and equality, enabling the Commission's staff to aid and further train the local tax assessors in the multi-faceted techniques of valuation through the use of periodic training seminars, clinics and similarly related programs.[202]

The judiciary's role is simple but critical. It must unwaveringly enforce the statutory and constitutional laws of the state.[203] The judiciaries in other states have played major roles in bringing about needed reforms, providing a model upon which the Mississippi courts may draw when faced with an equalization suit.[204]

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[200] The State Tax Commission is clearly given the authority by section 27-35-113 to ensure that all property is "assessed as nearly as possible at its true value." For the taxable property in each county to be assessed otherwise would be a clear violation of MISS. CONST. art. 4, § 112 and *id.* art. 7, § 181. Thus, for the State Tax Commission to provide interpretive guidelines is clearly in line with the statutory and constitutional law.

[201] The experts should include specialists in commercial, residential, industrial, oil and gas, agricultural and similar properties.

[202] In Astoria Plywood Corp. v. Department of Revenue, 258 Ore. 76, 481 P.2d 58 (1971), the Oregon Supreme Court emphatically stated that the taxing authority "must either educate its appraisers in the market or employ someone who is already familiar with it. It cannot for convenience or economy avoid its statutory duty." *Id.* at 62, *quoting with approval* Portland Canning Co. v. State Tax Comm'n, 241 Ore. 109, 404 P.2d 236, 238 (1965).

[203] This point is best made by the aftermath of the Ohio equalization case. The Ohio legislature, it seems, annually attempted to suspend the power of the Board of Tax Appeals to perform its duties. The Supreme Court of Ohio held that the legislature had no such power and ruled that

> [t]he county auditor, the Board of Revision, the Board of Tax Appeals, the General Assembly and this court are required to follow the provisions of Section 2 of Article XII of the Ohio Constitution and Section 1 of the Fourteenth Amendment to the Constitution of the United States—*now, as well as after 1972.*

State *ex rel.* Park Inv. Co. v. Board of Tax Appeals, 26 Ohio St. 2d 161, 270 N.E.2d 342, 345 (1971) (emphasis added).

[204] In Massachusetts, for example, the state's supreme court criticized the tax assessors for their apparent neglect of their sworn statutory duty, ultimately granting an injunction in favor of the plaintiff taxpayer from such further mistreatment.

> We have no doubt that may [*sic*] assessors have taken the oath and subscribed the statutory statement in the belief, or even on the advice of counsel, that it was to be understood in an Aesopian or Pickwickian sense. . . . We do not advocate wholesale prosecutions for knowing undervaluation or for perjury. But we do not understand how an assessor who subscribes "under the penalties of perjury" a statement that property has a full and fair cash value of $1,900 can be said to act lawfully or properly, whatever his motive or whatever the advice

In the final analysis, all that is suggested is that all property in Mississippi should be valued and assessed at its true value[205] and, accordingly, the mill rate should be adjusted to a realistic level. In determining true value, the economically sound and legally feasible approaches previously enumerated should be utilized. These steps should be taken not only because they are implicitly mandated in Mississippi's constitution and laws, but more importantly, because they are the tools necessary in determining a fair, reasonable and equitable taxable value of any property. When these steps are taken, the day will come when property taxation is uniform and equal throughout Mississippi. And maybe, just maybe, the taxpayers of this state—rich and poor alike—will feel that a modicum of fairness had crept into the system.

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he has received, if he knows that the property is worth $10,000.

Town of Sudbury v. Commissioner of Corps. & Taxation, 321 N.E.2d 641, 646 (Mass. 1974).

The judiciary's role was more simplistically pronounced by one court when it stated: "We are bound . . . to enforce both our State Constitution and our State statutes, and a taxpayer may of right call upon us to honor that obligation." *In re* Appeals of Kents 2124 Atlantic Ave., Inc., 34 N.J. 21, 166 A.2d 763, 767 (1961).

[205] The county tax assessor, by assessing taxable property at less than its true value, is clealy violating sections 112 and 181 of the Mississippi Constitution. Such a violation surely subjects every county tax assessor to criminal and civil liability, as is explicitly pronounced in the Mississippi statutory law.

> If any . . . assessor . . . shall knowingly or wilfully fail, neglect, or refuse to perform any of the duties required of him by law, or shall fail or refuse to keep any record required to be kept by law, or shall secrete the same, or shall violate his duty in any respect, he shall, on conviction thereof, be fined not exceeding one thousand dollars, or be imprisoned in the county jail not exceeding six months, or both.

MISS. CODE ANN. § 97-11-37 (1972).

> If any county . . . officer who has executed bond for the faithful performance of duty shall knowingly or wilfully fail, neglect, or refuse to perform any duty required of him by law or shall violate his official obligations in any respect, the president or, in the absence or disability or default of the president, the vice-president of the board of supervisors in case of a county or county district officer, and the mayor in case of a municipal officer, or any person interested in either case shall cause suit to be brought on the bond of such officer for the recovery of the damages that may have been sustained thereby.

MISS. CODE ANN. § 25-1-45 (1972).

APPENDIX I

AN HISTORICAL COMPARISON OF ASSESSMENT RATIOS FOR SELECTED MISSISSIPPI COUNTIES[1]

	M.E.C. Assessment-Sales Ratio Study 1962[2]	U.S. Bureau of the Census 1971[3]	Mississippi State Tax Commission 1972[4]	Grace Thesis 1973[5]	Davidson Trial 1974[6]
Adams	11.1%			30.0%	
Alcorn	10.9%			12.5%	15%
Amite	10.3%		9.8%	14.0%	20%
Attala	13.8%			20.0%	
Benton	11.1%			14.0%	
Bolivar	12.2%			20.0%	30%
Calhoun	10.4%			11.0%	15%
Carroll	16.3%			22.0%	
Chickasaw	14.1%			15.0%	
Choctaw	19.8%			20.0%	25%
Claiborne	20.2%			22.5%	20-25%
Clarke	11.2%			13.0%	20%
Clay	16.5%			17.3%	12%
Coahoma	24.9%			20.0%	

[1]This appendix is used to emphasize the gross percentage variations which exist in property assessment in the counties throughout Mississippi. Although the counties have not significantly varied their assessment schemes in the past decade, the method used in obtaining the assessment ratio in each county is far from uniform, inevitably breeding both intracounty and intercounty inequality.

[2]D. McKinney & P. Lowry, Mississippi Assessment-Sales Ratio Study, 1962 (1964).

[3]U.S. Bureau of the Census, Dep't of Commerce, Property Values Subject to Local General Property Taxation in the United States: 1971 (1972).

[4]House Ways & Means Comm., Study of Property Taxation, Interim Comm., Miss. Legislature (1973).

[5]J. Grace, Impact of Assessment Equalization on County Revenue and Homestead Exemption Reimbursement in Mississippi 37 (Aug. 1974) (unpublished thesis in Mississippi State University Library).

[6]Sworn Affidavits of County Tax Assessors, Davidson v. Baird, No. 10,046 (Cir. Ct. Sunflower Cty., Miss., Jan. 16, 1976).

APPENDIX I *(continued)*

	M.E.C. Assessment-Sales Ratio Study 1962	U.S. Bureau of the Census 1971	Mississippi State Tax Commission 1972	Grace Thesis 1973	Davidson Trial 1974
Copiah	14.3%			18.0%	20%
Covington	9.5%			12.1%	15%
Desoto	9.8%			20.0%	
Forrest	10.6%	11.0%		13.0%	10%
Franklin	12.4%			18.0%	25%
George	8.3%			10.0%	15%
Greene	13.9%			19.0%	15%
Grenada	13.7%			13.1%	20%
Hancock	10.0%			21.0%	15%
Harrison	8.0%			10.0%	
Hinds	19.0%			20.0%	
Holmes	18.5%			23.0%	35%
Humphreys	18.1%			20.0%	
Issaquena	13.7%			19.0%	20%
Ittawamba	10.7%			12.0%	20%
Jackson	8.1%	11.9%		24.0%	
Jasper	9.6%			10.0%	
Jefferson	18.3%			18.5%	25%
Jefferson Davis	13.7%			15.0%	
Jones	15.0%	10.5%		17.0%	20%
Kemper	12.0%			14.0%	10-15%
Lafayette	11.2%			15.0%	10%
Lamar	6.5%			10.0%	10%
Lauderdale	27.0%	22.7%		25.3%	25%
Lawrence	13.7%			25.0%	

APPENDIX I *(continued)*

	M.E.C. Assessment-Sales Ratio Study 1962	U.S. Bureau of the Census 1971	Mississippi State Tax Commission 1972	Grace Thesis 1973	Davidson Trial 1974
Leake	18.2%			19.0%	10%
Lee	12.9%			15.0%	25%
Leflore	14.0%			25.0%	
Lincoln	10.3%			13.0%	
Lowndes	16.1%			14.0%	25%
Madison	12.6%			13.0%	
Marion	14.5%			20.0%	
Marshall	13.3%			18.0%	
Monroe	13.2%			11.6%	13%
Montgomery	15.9%			20.0%	20%
Neshoba	12.8%			13.0%	
Newton	16.6%			20.0%	
Noxubee	19.1%			23.0%	
Oktibbeha	18.1%			19.0%	
Panola	12.7%			14.5%	10-15%
Pearl River	6.9%			22.0%	
Perry	15.4%		10.3%	19.0%	
Pike	15.2%			25.0%	22.5%
Pontotoc	9.9%			14.0%	15%
Prentiss	11.3%			13.0%	10%
Quitman	14.1%			20.0%	12%
Rankin	10.1%		8.2%	13.0%	15%
Scott	13.3%			14.0%	20%
Sharkey	12.3%			19.0%	20%
Simpson	10.0%			14.0%	20%
Smith	12.0%			17.0%	

APPENDIX I *(continued)*

	M.E.C. Assessment-Sales Ratio Study 1962	U.S. Bureau of the Census 1971	Mississippi State Tax Commission 1972	Grace Thesis 1973	Davidson Trial 1974
Stone	11.6%			14.0%	25%
Sunflower	15.5%			18.0%	12%
Tallahatchie	12.3%			15.8%	
Tate	12.3%			16.5%	
Tippah	11.2%			14.0%	
Tishomingo	7.3%			9.3%	
Tunica	13.8%			15.0%	
Union	11.8%			15.5%	15%
Walthall	11.6%			18.0%	15%
Warren	24.2%			30.0%	30%
Washington	11.2%	14.0%		20.0%	20%
Wayne	9.0%			15.0%	
Webster	15.2%			21.0%	15%
Wilkinson	12.2%			14.0%	25%
Winston	11.7%			15.0%	
Yalobusha	14.5%			17.0%	
Yazoo	20.1%			22.0%	20%

APPENDIX II

ASSESSMENT RATIOS IN 48 MISSISSIPPI COUNTIES: 1974

COUNTIES	Cultivatable Agricultural Lands	Buildings and Improvements on Cultivatable Agricultural or Rural Lands	Uncultivatable Agricultural or Rural Lands	Commercial Real Estate	Buildings and Improvements on Commercial Real Estate	Residential Real Estate	Buildings and Improvements on Residential Real Estate	Public Service Corporation and Utilities Real Estate	Buildings and Improvements on Public Service Corporation and Utilities Real Estate	Other Industrial Real Estate	Buildings and Improvements on Other Industrial Real Estate	Others
Adams								30%	30%			
Alcorn	Approximately $30.00 per acre	Approximately 15%	Approximately $10.00 per acre	Approximately 15%	Approximately 15%	Approximately 15%	Approximately 15%	30%	30%	Approximately 15%	Approximately 15%	
Amite	$11.00 per acre	15%	$9.00 per acre	20%	20%	15%	15%	30%	30%	Assessed by Tax Commission		
Attala								30%	30%			
Benton								30%	30%			
Bolivar	20%	20%	$10.00 per acre	30%	30%	20%	20%	30%	30%	30%	30%	
Calhoun	15%	15%	15%	15%	15%	15%	15%	30%	30%	15%	15%	

APPENDIX II *(continued)*

COUNTIES	Cultivatable Agricultural Lands	Buildings and Improvements on Cultivatable Agricultural or Rural Lands	Uncultivatable Agricultural or Rural Lands	Commercial Real Estate	Buildings and Improvements on Commercial Real Estate	Residential Real Estate	Buildings and Improvements on Residential Real Estate	Public Service Corporation and Utilities Real Estate	Buildings and Improvements on Public Service Corporation and Utilities Real Estate	Other Industrial Real Estate	Buildings and Improvements on Other Industrial Real Estate	Others
Carroll								30%	30%			
Chickasaw								30%	30%			
Choctaw	20%	20%	25%	25%	20%	20%	20%	30%	30%	25%	25%	
Claiborne	20-25%	20-25%	20-25%	20-25%	20-25%	20-25%	20-25%	30%	30%	0	0	
Clarke	$11 per acre	12% of cost	$9.00 per acre	*	20% of cost	*	12%	30%	30%			
Clay	10%	10%	10%	12%	12%	10%	10-12%	30%	30%			
Coahoma												
Copiah	20%	20%	20%	20%	20%	20%	20%	30%	30%	20%	20%	

***Assessment ratio depends on size and location—no set percentage.**

APPENDIX II *(continued)*

COUNTIES	Cultivatable Agricultural Lands	Buildings and Improvements on Cultivatable Agricultural or Rural Lands	Uncultivatable Agricultural or Rural Lands	Commercial Real Estate	Buildings and Improvements on Commercial Real Estate	Residential Real Estate	Buildings and Improvements on Residential Real Estate	Public Service Corporation and Utilities Real Estate	Buildings and Improvements on Public Service Corporation and Utilities Real Estate	Other Industrial Real Estate	Buildings and Improvements on Other Industrial Real Estate	Others
Covington	$12.00 per acre	10%	$9.00 per acre	15%	15%	10%	10%	30%	30%			
DeSoto								30%	30%			
Forrest	$15.00 per acre	10%	$12.00 per acre	10%	15%	10%	10%	30%	30%	10%	15%	
Franklin	$12.00 per acre		10%	25%	25%	15%	15%	30%	30%	25%	25%	
George	$14.00 per acre	15%	$11.00 per acre	15%	15%	15%	15%	30%	30%	15%	15%	
Greene	15%	15%	15%	15%	15%	15%	15%	30%	30%	15%	15%	
Grenada	10%	15%	8%	20%	25%	15%	15%	30%	30%	25%	25%	
Hancock	$12.50 per acre	15%	$10.00 per acre	15%	15%	15%	15%	30%	30%	15%	15%	

APPENDIX II (*continued*)

COUNTIES	Cultivatable Agricultural Lands	Buildings and Improvements on Cultivatable Agricultural or Rural Lands	Uncultivatable Agricultural or Rural Lands	Commercial Real Estate	Buildings and Improvements on Commercial Real Estate	Residential Real Estate	Buildings and Improvements on Residential Real Estate	Public Service Corporation and Utilities Real Estate	Buildings and Improvements on Public Service Corporation and Utilities Real Estate	Other Industrial Real Estate	Buildings and Improvements on Other Industrial Real Estate	Others
Harrison								30%	30%			
Hinds								30%	30%			
Holmes	20-35%	20-35%	Hill: 20% Delta: 30-35%	35%	35%	20%	20%	30%	30%	35%	35%	
Humphreys								30%	30%			
Issaquena	$25.00 per acre	20%	$12.00 per acre	20%	20% of value	None	None	30%	30%	None	None	
Itawamba	$12.33 per acre average	10% of value	$6.00 per acre average		20% of value	25% of value	10% of value	30%	30%		20% of value	
Jackson								30%	30%			

APPENDIX II *(continued)*

COUNTIES	Cultivatable Agricultural Lands	Buildings and Improvements on Cultivatabe Agricultural or Rural Lands	Uncultivatable Agricultural or Rural Lands	Commercial Real Estate	Buildings and Improvements on Commercial Real Estate	Residential Real Estate	Buildings and Improvements on Residential Real Estate	Public Service Corporation and Utilities Real Estate	Buildings and Improvements on Public Service Corporation and Utilities Real Estate	Other Industrial Real Estate	Buildings and Improvements on Other Industrial Real Estate	Others
Jasper								30%	30%			
Jefferson	$11.00 per acre	25%	$9.00 per acre	**	25%	**	25%	30%	30%			
Jefferson Davis	$12.00 per acre		$10.00 per acre					30%	30%			
Jones	$15.00 per acre	Approximately 20%	$15.00 per acre	Approximately 20%	Approximately 20%	Approximately 20%	Approximately 20%	30%	30%			
Kemper	$12.00 per acre	10-15%	$10.00 per acre	10-15%	10-15%	10-15%	10-15%	30%	30%	Granted 10 year tax exemption		
Lafayette	10% of $125.00 per acre	10%	10% of $100.00 per acre	10%	10%	10%	10%	30%	30%			Personal Property 30%
Lamar	$12.00 per acre	10%	$9.00 per acre	10%	10%	10%	10%	30%	30%			

**Lots assessed from $100 to $200.

APPENDIX II *(continued)*

COUNTIES	Cultivatable Agricultural Lands	Buildings and Improvements on Cultivatable Agricultural or Rural Lands	Uncultivatable Agricultural or Rural Lands	Commercial Real Estate	Buildings and Improvements on Commercial Real Estate	Residential Real Estate	Buildings and Improvements on Residential Real Estate	Public Service Corporation and Utilities Real Estate	Buildings and Improvements on Public Service Corporation and Utilities Real Estate	Other Industrial Real Estate	Buildings and Improvements on Other Industrial Real Estate	Others
Lauderdale	Approximately 15%	Approximately 25%	Approximately 15%	Approximately 15%	Approximately 25%	Approximately 15%	Approximately 25%			Approximately 15%	Approximately 25%	
Lawrence								30%	30%			
Leake	10%	10%	10%	10%	10%	10%	10%	30%	30%	10%	10%	
Lee	18.77%	16%	10.88%	25%	25%	15%	15%	30%	30%	25%	25%	
Leflore								30%	30%			
Lincoln								30%	30%			
Lowndes	$16.00 per acre	25% of assessed value	$8.00 per acre	25%	25%	25%	25%	30%	30%	25%	25%	same
Madison								30%	30%			

APPENDIX II *(continued)*

COUNTIES	Cultivatable Agricultural Lands	Buildings and Improvements on Cultivatable Agricultural or Rural Lands	Uncultivatable Agricultural or Rural Lands	Commercial Real Estate	Buildings and Improvements on Commercial Real Estate	Residential Real Estate	Buildings and Improvements on Residential Real Estate	Public Service Corporation and Utilities Real Estate	Buildings and Improvements on Public Service Corporation and Utilities Real Estate	Other Industrial Real Estate	Buildings and Improvements on Other Industrial Real Estate	Others
Marion								30%	30%			
Marshall								30%	30%			
Monroe	$15.40 per acre average	10%	$6.20 per acre average	13%	13%	10%	10%	30%	30%	20%	20%	
Montgomery	$14.00 per acre	16%	$8.50 per acre	20%	20%	16%	16%	30%	30%	20%	20%	
Neshoba								30%	30%			
Newton								30%	30%			
Noxubee								30%	30%			
Oktibbeha								30%	30%			

APPENDIX II *(continued)*

COUNTIES	Cultivatable Agricultural Lands	Buildings and Improvements on Cultivatable Agricultural or Rural Lands	Uncultivatable Agricultural or Rural Lands	Commercial Real Estate	Buildings and Improvements on Commercial Real Estate	Residential Real Estate	Buildings and Improvements on Residential Real Estate	Public Service Corporation and Utilities Real Estate	Buildings and Improvements on Public Service Corporation and Utilities Real Estate	Other Industrial Real Estate	Buildings and Improvements on Other Industrial Real Estate	Others
Panola	$20.00 per acre	10-15%	$10.00 per acre	10-15%	10-15%	10-15%	10-15%	30%	30%	10-15%	10-15%	
Pearl River								30%	30%			
Perry								30%	30%			
Pike	22.5%	22.5%	22.5%	22.5%	22.5%	22.5%	22.5%	30%	30%	22.5%	22.5%	
Pontotoc	7%	10%	5%	10%	15%	7%	10%	30%	30%			
Prentiss	10%	10%	10%	10%	10%	10%	10%	30%	30%	10%	10%	
Quitman	$25-$35 per acre	12%	$7.50 per acre	12% of value	12%	12%	12%	30%	30%	12%	12%	
Rankin	$15.00 per acre	10%	$12.00 per acre	20%	15%	$200 per lot	10%	30%	30%	20%	15%	

APPENDIX II *(continued)*

COUNTIES	Cultivatable Agricultural Lands	Buildings and Improvements on Cultivatable Agricultural or Rural Lands	Uncultivatable Agricultural or Rural Lands	Commercial Real Estate	Buildings and Improvements on Commercial Real Estate	Residential Real Estate	Buildings and Improvements on Residential Real Estate	Public Service Corporation and Utilities Real Estate	Buildings and Improvements on Public Service Corporation and Utilities Real Estate	Other Industrial Real Estate	Buildings and Improvements on Other Industrial Real Estate	Others
Scott	11% per acre	15-20%	9% per acre	25%	20%	15-20%	20%	30%	30%			
Sharkey	10%	10%	10%	20%	20%	10%	10%	30%	30%			
Simpson	$12.00 per acre	15%	$10.00 per acre	20%	20%	20%	20%	30%	30%			
Smith								30%	30%			
Stone	20%	20%	20%	25%	25%	20%	20%	30%	30%			
Sunflower	12%		12%	12%		12%		30%	30%	12%		
Tallahatchie								30%	30%			
Tate								30%	30%			
Tippah								30%	30%			

APPENDIX II *(continued)*

COUNTIES	Cultivatable Agricultural Lands	Buildings and Improvements on Cultivatable Agricultural or Rural Lands	Uncultivatable Agricultural or Rural Lands	Commercial Real Estate	Buildings and Improvements on Commercial Real Estate	Residential Real Estate	Buildings and Improvements on Residential Real Estate	Public Service Corporation and Utilities Real Estate	Buildings and Improvements on Public Service Corporation and Utilities Real Estate	Other Industrial Real Estate	Buildings and Improvements on Other Industrial Real Estate	Others
Tishomingo								30%	30%			
Tunica								30%	30%			
Union	15%	15%	15%	15%	15%	15%	15%	30%	30%	15%	15%	
Walthall	4%	15%	4%	10%	15%	10%	15%	30%	30%	10%	15%	
Warren	Variable	30%	Variable	30%	30%	30%	30%	30%	30%	30%	30%	
Washington	***	20% if true value is known	$30-$50 per acre	20%	20%	15%	15%	30%	30%	20%	20%	None
Wayne								30%	30%			

***Cultivatable agricultural property varyingly assessed between $40 and $250 per acre depending on factors such as proximity to highway, navigation, railroad, town, road, etc.

APPENDIX II *(continued)*

COUNTIES	Cultivatable Agricultural Lands	Buildings and Improvements on Cultivatable Agricultural or Rural Lands	Uncultivatable Agricultural or Rural Lands	Commercial Real Estate	Buildings and Improvements on Commercial Real Estate	Residential Real Estate	Buildings and Improvements on Residential Real Estate	Public Service Corporation and Utilities Real Estate	Buildings and Improvements on Public Service Corporation and Utilities Real Estate	Other Industrial Real Estate	Buildings and Improvements on Other Industrial Real Estate	Others
Webster	$15.00 per acre	15%	$8.00 per acre	15%	15%	15%	15%	30%	30%	15%	15%	
Wilkinson	$10.00 per acre	15%	$11-$12 per acre		25%		15%	30%	30%			
Winston								30%	30%			
Yalobusha								30%	30%			
Yazoo	10%	20%	10%	20%	20%	22%	20%	30%	30%	20%	20%	

THE DOCTRINE OF RES IPSA LOQUITUR IN NEGLIGENCE ACTIONS—OLD SOLUTIONS FOR NEW PROBLEMS

*L. Ellis Griffith**
*Benjamin E. Griffith***

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* B.A. 1951, Mississippi College; J.D. 1951, University of Mississippi; LL.M. 1952, New York University; Partner, Jacobs, Griffith & Povall, Cleveland, Mississippi.

** B.A. 1973; J.D. 1975, University of Mississippi; Associate, Jacobs, Griffith & Povall, Cleveland, Mississippi.

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Following Mississippi's adoption of the theory of strict liability in tort in *State Stove Manufacturing Co. v. Hodges,*[1] recovery based upon general negligence principles has been sought in fewer products liability cases in this state.[2] This noticeable shift away from reliance upon deeply-rooted general neligence principles in the products liability field has been accompanied by an obfuscation of legal theories generally applicable in tort actions. The theory of strict liability in tort, heralded as a panacea for the wronged consumer, was soon found to embody a host of new problems that even now are requiring the best efforts of the bench and bar for solution. Beyond the field of products liability, however, the negligence theory of action—coupled with its much relied on vehicle of proof, the doctrine of res ipsa loquitur—has undergone considerable expansion. Such expansion perhaps reflects our legal system's response to increasing and ingenious attempts at almost every level of society to delegate or evade responsibility.

This article will first analyze the background and common law refinements in the application of the doctrine of res ipsa loquitur. In addition, the authors will evaluate the utility of the "old time religion" of long-settled general negligence principles in the context of products liability. Special emphasis will be accorded recent and somewhat curious developments surrounding the doctrine of res ipsa loquitur.

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[1] 189 So. 2d 113 (Miss. 1966), *cert. denied,* 386 U.S. 912 (1967).

[2] Litigants have favored the strict liability in tort theory set forth in section 402A of the RESTATEMENT (SECOND) OF TORTS. Maraist & Barksdale, *Mississippi Products Liability—A Critical Analysis,* 43 MISS. L.J. 139, 145 (1972).

I. Background

A. *Statement of the Doctrine*

The doctrine of res ipsa loquitur is a rule of circumstantial evidence that permits the jury, under certain circumstances, to draw an inference of the defendant's negligence.[3] Although the plaintiff in a typical negligence action has the burden of proving the existence of a duty owed by the defendant, a breach of that duty, a causal relationship between the breach and the plaintiff's injury, and resulting damage,[4] in some instances the plaintiff may not have access to affirmative evidence of the defendant's negligence. In this limited category of cases, res ipsa loquitur may supply the missing link—the fact of the defendant's negligence. Stated differently, the facts surrounding the injury-causing occurrence eloquently speak for themselves in furnishing circumstantial evidence of the defendant's negligence.[5]

As formulated by the Mississippi Supreme Court, the doctrine is applicable only if four requirements are satisfied: (1) the accident must be one which ordinarily would not occur in the absence of someone's negligence; (2) the instrumentality which caused the accident must have been within the defendant's exclusive contol; (3) the injured party's conduct must not have contributed to the accident; and (4) the injured party must not be in a position to show the particular circumstances which caused the instrumentality to injure him.[6] When these prerequisites are satisfied, the jury is permitted to infer that, had the defendant exercised due care, the accident simply would not have happened.[7] In the absence of a sufficient explanation or rebuttal of this inference, the plaintiff's injury may be found to have been caused by the defendant's negligence despite the lack of direct evidence.[8]

The doctrine is, however, subject to several restrictions and limitations. For example, "inferences may not be pyramided beyond the bounds of legitimate conclusion" in showing that the defendant's negligence proximately contributed to the damage.[9] Further, mere proof of the alleged injury does not support an inference of negligence,[10] and, of

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[3] Johnson v. Foster, 202 So. 2d 520, 524 (Miss. 1967).

[4] Walton v. Chrysler Motor Corp., 229 So. 2d 569, 573 (Miss. 1969).

[5] Weston, *A Defense Lawyer Looks at Products Liability and Res Ipsa Loquitur*, 29 Ins. Counsel J. 576, 576 (1962).

[6] Morgan v. Mississippi Power Co., 298 So. 2d 698, 700 (Miss. 1974); Clark v. Vardaman Mfg. Co., 249 Miss. 42, 44, 160 So. 2d 857, 858 (1964).

[7] Waddle v. Sutherland, 156 Miss. 540, 550, 126 So. 201, 203 (1930).

[8] Peerless Supply Co. v. Jeter, 218 Miss. 61, 68, 65 So. 2d 240, 242 (1953).

[9] Tombigbee Elec. Power Ass'n v. Gandy, 216 Miss. 444, 452, 62 So. 2d 567, 569 (1953).

[10] *See* Wickton v. Louisville & N. Ry., 45 F.2d 615, 618 (S.D. Miss. 1930); Waddle v. Sutherland, 156 Miss. 540, 549, 126 So. 201, 203 (1930).

course, a mere scintilla of evidence of negligence is insufficient to make a jury issue in any negligence case.[11] In addition, the jury is not bound to draw the permissible inference even in the absence of rebuttal evidence.[12] Finally, while the nature and underlying facts of the occurrence must make it probable that the plaintiff's injury was caused by the defendant's negligence, res ipsa will never supply the proximate cause.[13] The fact of negligence must have existed in the causal chain beginning with the defendant's act or omission and extending to the injury complained of, even though the particular harmful conduct of the defendant need not be set forth.[14] Despite these restrictions and limitations, a plaintiff may employ the doctrine to establish a prima facie case of negligence sufficient to withstand a motion for a directed verdict.[15]

B. Origin and Development of the Doctrine

The expression "res ipsa loquitur" was introduced to Anglo-Saxon law by the 1863 case of *Byrne v. Boadle.*[16] In *Byrne,* a barrel of flour fell from a window of the defendant's warehouse and struck a passing pedestrian, the plaintiff. Despite his inability to show how or why the barrel rolled out of the window, the plaintiff was permitted to recover upon a showing that the defendant was in possession of the warehouse.[17] During the brief argument concerning the need for some affirmative proof of the defendant's negligence, Chief Baron Pollock casually remarked that "[t]here are certain cases of which it may be said res ipsa loquitur, and this seems one of them."[18]

From its simple origin as a common sense appraisal of the probative force of circumstantial evidence, res ipsa has gained recognition as a device for getting the plaintiff to the jury in the name of negligence.[19] Although it has been dubbed a "thinly concealed circumvention of the

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[11] Hertz v. Goza, 306 So. 2d 657, 660 (Miss. 1974); Berry v. Brunt, 252 Miss. 194, 203, 172 So. 2d 398, 402 (1965).

[12] Fisher v. Daniels, 252 Miss. 662, 676, 173 So. 2d 908, 914 (1965).

[13] Note, *Malpractice in Mississippi,* 23 MISS. L.J. 141, 141 (1952).

[14] Haasman v. Pacific Alaska Air Express, 100 F. Supp. 1, 2 (D. Alas. 1951), *aff'd sub nom.,* Des Marais v. Beckman, 198 F.2d 550 (9th Cir. 1952); Witherspoon, *Do You Have a Products Liability Case?,* 36 MISS. L.J. 30, 40 (1964).

[15] Note, *supra* note 13, at 142. Although the defendant's "exclusive knowledge and control of the evidence may be a sufficient reason to apply the doctrine," it does not follow that the unavailability of the evidence to both parties will preclude its application. Johnson v. Foster, 202 So. 2d 520, 525 (Miss. 1967).

[16] 159 Eng. Rep. 299 (Ex. 1863).

[17] *Id.* at 301.

[18] *Id.* at 300.

[19] Gregory, *Trespass to Negligence to Absolute Liability,* 37 VA. L. REV. 359, 381 (1951).

theory of absolute liability,"[20] the doctrine nevertheless has proven to be a significant mode of de-emphasizing the rigid, albeit logical, pursuit of fault in an age when the emphasis on fault itself has been mitigated.[21] In view of the increasing tendency in negligence actions to extend the defendant's responsibility and to limit the plaintiff's, one may anticipate an increasing number of attempts to apply the doctrine of res ipsa loquitur to a wider range of cases.[22]

C. *Rationale Underlying the Doctrine's Use*

It should be noted at the outset that res ipsa loquitur cannot apply to every unexplained accident or occurrence. In addition, the rules of liability—such as the principle that a master may be held liable only for his servant's proven lack of reasonable care—are not altered by the doctrine.[23] Where a defendant is able to show that accidents such as the one complained of do in fact happen despite all reasonable precautions, he may in effect mitigate the very premise upon which the doctrine stands. Indeed, the doctrine's application is precluded when the court makes this finding on the basis of common experience.[24]

A primary justification for allowing a plaintiff to use res ipsa loquitur is that affirmative evidence of a defendant's negligence is more than likely within the defendant's exclusive knowledge and control.[25] This is not, however, the sole reason for the doctrine's existence. Indeed, it may apply even when evidence is not available to either party.[26]

Because of the prerequisite that the plaintiff be unable to show specific acts of negligence, equality of knowledge may preclude application of the doctrine. On the other hand,

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[20] *Id.*

[21] James, *Proof of the Breach in Negligence Cases (Including Res Ipsa Loquitur)*, 37 VA. L. REV. 179, 228 (1951). *See also* Traynor, *The Ways and Meanings of Defective Products in Strict Liability*, 32 TENN. L. REV. 363 (1965). The Mississippi legislature's recent relaxation of the fault concept in a divorce context is, perhaps irreconcilably, illustrative of this trend. Act of May 20, 1976, ch. 451, 1976 Miss. Laws 704.

[22] Weston, *supra* note 5, at 577.

[23] Gulfport Creosoting Co. v. White, 171 Miss. 127, 133, 157 So. 86, 88 (1934).

[24] 2 F. HARPER & F. JAMES, THE LAW OF TORTS § 19.2 (1956).

[25] Johnson v. Foster, 202 So. 2d 520, 525 (Miss. 1967).

[26] *Id.* The Mississippi Supreme Court has stated:

> "It is therefore not a matter of the defendant's ability to speak, but the fact that the act itself speaks. It would be just as logical to say that if a defendant does not know the cause of an accident, a plaintiff might not recover. A defendant might purposely say he did not know. If he did so he might as well be dead in so far as the plaintiff was concerned, for if a defendant could or would not speak the plaintiff must fail."

Id. (citation omitted).

> it does not follow that . . . equality of ignorance will likewise preclude applicability, for the function of the doctrine . . . is to supply a fact, i.e. defendant's negligence, which must have existed in the causal chain stretching from the act or omission by the defendant to the injury suffered by the plaintiff, but which the plaintiff because of circumstances surrounding the causal chain, cannot know and cannot prove to have actually existed.[27]

If the plaintiff does not have equal access to the facts, or if the defendant is in a position to have superior knowledge of them, the plaintiff may rely upon the doctrine to avoid a directed verdict. On the other hand, since the inference arising under the doctrine is a permissible one, the courts may be reluctant to grant a directed verdict or judgment notwithstanding the verdict for the plaintiff. However, in the absence of proof to the contrary, the circumstances may render the inference a necessary one, justifying judgment as a matter of law for the plaintiff.[28] Conversely, if the defendant offers evidence that so fully explains the accident as to overcome the permissible inference of negligence, a court could justifiably render judgment for the defendant as a matter of law.[29]

It is readily apparent that the crux of the res ipsa doctrine is found in the control and management of the offending instrumentality at the time of the injury-causing occurrence. Since this control and management places the defendant in a superior position to know or ascertain the cause of the plaintiff's injuries, the defendant is saddled with the "burden of explanation."[30] In the same context, an inherent limitation in the use and application of the doctrine arises from the requirement that the injury could in all probability only have been caused by an instrumentality under the management and control of the defendant. Thus, if the defendant successfully establishes several probable causes of the injury and that some of these causes do not in any way relate to his negligence, the plaintiff cannot recover through reliance upon the doctrine.[31]

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[27] Haasman v. Pacific Alaska Air Express, 100 F. Supp. 1, 2 (D. Alas. 1951), *aff'd sub nom.*, Des Marais v. Beckman, 198 F.2d 550 (9th Cir. 1952).

[28] 9 C. WRIGHT & A. MILLER, FEDERAL PRACTICE & PROCEDURE § 2528, at 570 (1973); *cf.* Alabama & V. Ry. v. Groome, 97 Miss. 201, 52 So. 703 (1910) (presumption of negligence as a matter of law).

[29] 9 C. WRIGHT & A. MILLER, *supra* note 28, § 2528, at 570; *see* Atchison, T. & S. F. Ry. v. Simmons, 153 F.2d 206, 208 (10th Cir. 1946).

In the typical res ipsa case, however, the defendant should have the burden of meeting an inference of negligence, and the jury should be allowed to determine the issue of negligence. Otherwise, the plaintiff could be deprived of his day in court simply for the lack of reasonable access to the facts. *See* Johnson v. Foster, 202 So. 2d 520, 524 (Miss. 1967).

[30] Reed, *Products Liability: Res Ipsa Loquitur*, 1963 INS. L. J. 5, 16.

[31] Custy, *Tort Liability in Oil and Gas Operations in Mississippi*, 44 MISS. L.J. 637, 643 (1973).

II. Operation and Effect

A. Generally

Despite the continuing battle of the courts and commentators concerning the legitimate and proper procedural effect of res ipsa,[32] the Mississippi Supreme Court apparently has resolved the problem of whether the doctrine creates a presumption or an inference of negligence. The following summary indicates that the court's resolution was largely by default, insofar as consideration of the presumption vis-à-vis inference issue was pretermitted until the "problem" vanished.

Although all presumptions are inferences, not all inferences are presumptions. The possible distinction may be that an inference involves matters of fact rather than matters of law.[33] Consequently, only those inferences that are considered practical and procedural expedients and that the courts have adopted as safe and justifiable generalities are deemed to be presumptions.[34] Despite these distinctions, the precise procedural effect to be afforded res ipsa was, due to loose language on the part of the Mississippi Supreme Court,[35] a confused subject for a considerable period of time. Yet, despite the court's relatively innocuous commingling of the terms "presumption" and "inference," its decisions seem to indicate an adherence to the view that res ipsa is merely one form of circumstantial evidence from which a jury may permissibly draw an inference of negligence.

The court's decision in *Bloch v. Brown*[36] eliminated some of the long standing confusion in this area. In that case, the court disapproved jury instructions relating to the "presumption" implicit in the doctrine.

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[32] 2 F. Harper & F. James, *supra* note 24, § 19.11, at 1104.

[33] 9 J. Wigmore, A Treatise on Evidence § 2491, at 288 (3d ed. 1940).

[34] According to former Justice Alexander, presumptions are

> merely accepted patterns of circumstantial evidence, justified by experience and sustained by logic and reason, and above all, in their technical sense standardized as accepted formulas for justifying the acceptance of logically related fact from the proof of another fact. The reasons for casting these devices into moulds include the policy of saving time and expense, in which aspect they are mere variants of judicial notice, or to surmount a disproportionate difficulty of detailed proof, or because the ultimate fact is peculiarly in the possession or knowledge of the adverse party. Public policy and the exigencies of the social order explain their invention.

Alexander, *Presumptions: Their Use and Abuse*, 17 Miss. L.J. 1, 2 (1945).

[35] *See, e.g.*, J. C. Penney Co. v. Evans, 172 Miss. 900, 905-06, 160 So. 779, 780-81 (1935); Waddle v. Sutherland, 156 Miss. 540, 549-50, 126 So. 201, 203 (1930) (court referred to "reasonable inference" of negligence arising by application of doctrine and refused instructions that would allow jury to consider "prima facie presumption" that injury was caused by defendant's negligence); Gulf & S.I.R.R. v. Odum, 133 Miss. 543, 544, 98 So. 60, 61 (1923) (court referred to "presumption" arising from the doctrine).

[36] 201 Miss. 653, 29 So. 2d 665 (1947).

> Presumptions are for the judge and not the jury. Once they have served the purpose of making a prima facie case, their function ceases and the case goes to the jury free of the incident that the inferences thereby created have any force other than that which the jury may by their own reasoning attach to them.[37]

While refusing to prescribe a precise jury instruction addressing the res ipsa burden of proof, the court indicated the desirability of an instruction which would leave the official burden of proof upon the plaintiff, yet would advise the jury of the defendant's burden to come forward with some explanation. According to the court,

> [w]hile the inference of negligence from an unexplained [event] is sufficient for the trained judge who accepts its force as adequate to the establishment of a prima facie case, the jurors are aware of no such standardized formula. It is true that the inferences implicit in the doctrine remain available as such, and are commended to the reason and judgment of the jury as being logically relevant, since the legal presumption is genuine and not arbitrary nor spurious. Yet, the jurors, left solely to their own resources of reason and logic and admonished that the applicable legal principles are embodied in the instructions, are apt to charge against a plaintiff any failure fully to explain the catastrophe by direct proof and to withhold the very inferences which the doctrine was designed to supply. The plaintiff is therefore entitled to an instruction stating, in substance, that proper and adequate proof of [the event] places some burden upon the defendant. The extent of this defensive burden is at most merely to adjust the scales to equipoise but not to preponderance.[38]

Following *Bloch*, the court, with only an occasional slip of the tongue,[39] has consistently recognized that res ipsa creates only a permissible inference of negligence.[40] The court has further noted that the doctrine places an explanatory burden on the defendant—one which requires him to come forward with a satisfactory explanation or rebuttal of the inference.[41]

Even if the doctrine applies, the plaintiff is not wholly relieved of his burden of proof. Indeed, the burden of proving the defendant's negligence by a preponderance of the evidence rests upon the plaintiff

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[37] *Id.* at 660, 29 So. 2d at 667.

[38] *Id.* at 663, 29 So. 2d at 668.

[39] *See, e.g.*, Palmer v. Clarksdale Hosp., 206 Miss. 680, 698-99, 40 So. 2d 582, 586 (1949) (doctrine raised "presumption" of negligence to extent that defendant was required to explain it).

[40] *See, e.g.*, Johnson v. Foster, 202 So. 2d 520, 524 (Miss. 1967); Dees v. Campbell, 183 So. 2d 624, 626 (Miss. 1966).

[41] *E.g.*, Johnson v. Coca-Cola Bottling Co., 239 Miss. 759, 773, 125 So. 2d 537, 543 (1960).

throughout the case; only the burden of advancing explanatory or rebuttal evidence is shifted to the defendant.[42] Furthermore, in addition to meeting the initial prerequisites, the plaintiff's proof must include a showing that the defendant's negligence proximately caused his injury.[43]

The doctrine's precise procedural effect ultimately depends upon the strength of the inferences to be drawn. This strength, of course, varies with the facts and circumstances of each case.[44] Consequently, the sufficiency of the defendant's explanatory or rebuttal evidence is a question of fact for the jury. Indeed, one writer has observed that, as a matter of law, a court is not authorized to declare that the inference of negligence has been vitiated by the defendant's rebuttal or explanation of the circumstances.[45]

Res ipsa does not obviate the necessity of proving an essential element of liability under substantive law, but pertains solely to a method by which that proof may be made in a proper case.[46] Once conditions precedent to the doctrine's application have been satisfied, proof that the injury was caused by a peculiar factual situation for which the defendant was not responsible may be employed to rebut the inference of negligence. Nevertheless, such proof does not avoid the doctrine's application[47] unless both parties undertake to explain the accident by offering evidence and producing witnesses.[48]

B. Pleading and Proof

Although negligence may be established by circumstantial evidence under the doctrine of res ipsa loquitur, evidence must be produced from which a reasonable person may infer that it is more probable than not that the event was caused by such negligence.[49] Except in rare cases, proof that a certain event transpired as a result of a stated condition, without more, is proof only of the possibility and does not establish the probability. Verdicts cannot be based upon such speculation.[50] Thus, the doctrine deals with the quantum of proof necessary to meet the burden placed upon the party asserting negligence as the basis of his claim.[51]

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[42] *See id.*

[43] Milner Enterprises, Inc. v. Jacobs, 207 So. 2d 85, 91 (Miss. 1968).

[44] Dees v. Campbell, 183 So. 2d 624, 626 (Miss. 1966).

[45] 1 S. SPEISER, THE NEGLIGENCE CASE—RES IPSA LOQUITUR § 5:26, at 205 (1972).

[46] Gulfport Creosoting Co. v. White, 171 Miss. 127, 134, 157 So. 86, 88 (1934).

[47] 32 MISS. L.J. 329, 331 (1961).

[48] Lyle v. Johnson, 240 Miss. 154, 164, 126 So. 2d 266, 270 (1961). *See generally* Landrum v. Smith, 233 So. 2d 217 (Miss. 1970).

[49] Dees v. Campbell, 183 So. 2d 624, 626 (Miss. 1966).

[50] Gates v. Greyhound Corp., 197 F. Supp. 341, 345 (S.D. Miss. 1960).

[51] 1 B. JONES, EVIDENCE § 20, at 42 (5th ed. 1958).

One somewhat unique procedural tactic was recognized in *Smith v. Pennsylvania Central Airlines Corp.*,[52] where the court permitted the defendant to test the doctrine's applicability by a motion to strike specific allegations. Although the Federal Rules of Civil Procedure make no express provision for such a use of the motion, the court reasoned that "[u]nless this course is permitted, the defendant may be without remedy at this stage of litigation."[53] In this context, Wright and Miller have observed:

> Although the result reached in *Smith* seems acceptable, it is doubtful that it is necessary to create a "common law" motion to strike insufficient counts or claims that parallels the Rule 12(f) motion to strike an insufficient defense. Rule 12(b)(6) is flexible enough to encompass a motion directed to a portion of the complaint. Moreover, a summary judgment motion seems to be an appropriate alternative to a motion to strike.[54]

Since the issue of whether the defendant's conduct meets the reasonable person standard is normally reserved for the jury, the federal courts generally have denied motions for summary judgment on the res ipsa issue.[55] If the movant clearly establishes that no genuine dispute exists as to any material fact controlling the doctrine's application, however, summary judgment may be a proper method of disposing of a res ipsa claim.[56]

1. General Allegations of Negligence

Where a plaintiff in a res ipsa case sets forth general allegations of negligence against multiple defendants, it should be clear that the defendants are not only jointly liable, but also stand in the same shoes with respect to liability.[57] Thus, in relying upon the doctrine, it is advisable that the plaintiff forego proving any specific act of negligence on the part of the defendant.[58] Indeed, if the plaintiff does seek to prove a specific act of negligence and if all of the facts relating to the defendant's negligence are brought before the jury, there will be no room left for the doctrine's permissible inference.[59]

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[52] 76 F. Supp. 940 (D.D.C. 1948).
[53] *Id.* at 942.
[54] 5 C. WRIGHT & A. MILLER, FEDERAL PRACTICE & PROCEDURE § 1383, at 835 (1973).
[55] 10 *id.* § 2729, at 574 n.89.
[56] Honey v. George Hyman Constr. Co., 63 F.R.D. 443, 451 (D.D.C. 1974).
[57] *See* 30 MISS. L.J. 90, 90 (1958).
[58] *See* J. C. Penney Co. v. Evans, 172 Miss. 900, 914, 160 So. 779, 780-81 (1935).
[59] Ross v. Hodges, 234 So. 2d 905, 908 (Miss. 1970).

2. Specific Allegations of Negligence

When a plaintiff alleges specific acts of negligence, the doctrine of res ipsa loquitur may, to a limited extent, still apply.[60] Thus, if a declaration sets forth only specific acts or omissions alleged to constitute negligence, the doctrine may be invoked only to the extent of proving those specific allegations.[61] In other words, the jury may infer only that the defendant was negligent in the manner specifically set forth, and the defendant need explain or rebut only those acts of negligence specifically charged.[62] It is indeed logical and fair to confine the plaintiff's proof to the specific acts of negligence alleged in his complaint. This is true because the defendant is entitled to prepare his defense with respect to the ground of negligence upon which the plaintiff relies.[63] However, if the plaintiff alleges, but does not prove or attempt to prove specific acts of negligence, the doctrine may be relied upon without this limitation.[64]

In the federal courts, the general rule which permits a plaintiff to rely upon general allegations of negligence rather than detail the specific circumstances of his claim has been applied in a res ipsa context.[65] Indeed, if the plaintiff pleads specific acts of negligence, he may run the risk of waiving the right to rely upon the doctrine.[66]

3. Rebuttal Evidence

a. Causation

A plaintiff is not permitted to rely upon res ipsa loquitur when specific proof discloses some reasonable explanation for the accident other than the negligence of the defendant.[67] Under analogous circumstances, the doctrine will not apply if

> "the evidence discloses that the injury might have occurred by reason of the concurrent negligence of two or more persons or causes, one of

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[60] Alabama & V. Ry. v. Groome, 97 Miss. 201, 207, 52 So. 703, 705 (1910).

[61] *Id.*

[62] Aponaug Mfg. Co. v. Carroll, 183 Miss. 793, 798-99, 184 So. 63, 64-65 (1938).

[63] *Id.*

[64] *See* Johnson v. Coca-Cola Bottling Co., 239 Miss. 759, 773, 125 So. 2d 537, 543 (1961).

[65] *See, e.g.*, Fassbinder v. Pennsylvania R.R., 322 F.2d 859, 863-64 (3d Cir. 1963) (negligence "in permitting a broken dog on the car" and in failing "to make proper repairs" specifically alleged; res ipsa applicable under general allegation of negligence).

[66] Nuclear Corp. v. Lang, 337 F. Supp. 914, 920 (D. Neb. 1972), *aff'd*, 480 F.2d 990 (8th Cir. 1973), *noted in* 52 NEB. L. REV. 404 (1973).

[67] Yazoo & Miss. V.R.R. v. Skaggs, 181 Miss. 150, 158, 179 So. 274, 277 (1938).

> which was not under the [exclusive] management and control of [the] defendant,"[68]

or if there is direct evidence of the precise cause of the injury.[69] Assuming applicability, the test of liability under res ipsa is not whether the defendant can explain the specific cause of the injury, but whether he can show that he used reasonable diligence to prevent the happening.[70]

Since res ipsa never supplies the requisite proximate cause,[71] that element of the plaintiff's cause of action must be independently established.[72] This may be accomplished by the introduction of circumstantial evidence sufficient to take the case out of the realm of conjecture and place it within the realm of legitimate inference.[73] The plaintiff, however, cannot successfully rely upon such evidence if the facts and circumstances of the occurrence allow an equally reasonable inference that attributes the injury to another cause.[74] Thus, the plaintiff can significantly increase his chances for success by eliminating other possible intervening causes of the injury.[75]

It is not a defense for a defendant to say that he does not know the cause of an accident. He may affirmatively show the cause of the accident and perhaps exculpate himself from liability, but his inability or refusal to show the cause in no way affects the plaintiff's right to recover.[76] The defendant may, however, overcome the permissible inference of negligence with both negative and positive evidence by showing attending facts and circumstances completely rebutting the inference or by showing the absence of any fact or circumstance from which negligence could reasonably be inferred.[77] Also, since the inference may be rebutted by proper evidence,[78] if the plaintiff is shown to have materially contributed to his own injury, such as by voluntary intoxication, res ipsa will not apply.[79] According to Professors Harper and James, the defen-

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[68] Denman v. Denman, 242 Miss. 59, 69-70, 134 So. 2d 457, 461 (1961), *quoting* 9B W. BANDY, BLASHFIELD'S CYCLOPEDIA OF AUTOMOBILE LAW AND PRACTICE § 6046, at 456 (1954).

[69] DeLaughter v. Womack, 250 Miss. 190, 197, 164 So. 2d 762, 771 (1964).

[70] Peerless Supply Co. v. Jeter, 218 Miss. 61, 69, 65 So. 2d 240, 242 (1953).

[71] Baker v. Ford Motor Co., 317 So. 2d 51, 54 (Miss. 1975); Sanders v. Smith, 200 Miss. 551, 560, 27 So. 2d 889, 893 (1946) (Alexander, J., concurring).

[72] Baker v. Ford Motor Co., 317 So. 2d 51, 54 (Miss. 1975).

[73] Shell Oil Co. v. Ainsworth, 247 So. 2d 815, 817 (Miss. 1971); *see* Maxie v. Laurel Gen. Hosp., 130 Miss. 246, 250-51, 93 So. 817, 817 (1922).

[74] Yazoo & Miss. V.R.R. v. Skaggs, 181 Miss. 150, 158, 179 So. 274, 277 (1938).

[75] Johnson v. Coca-Cola Bottling Co., 239 Miss. 759, 765, 125 So. 2d 537, 541 (1961).

[76] Johnson v. Foster, 202 So. 2d 520, 525 (Miss. 1967).

[77] Gulf & S.I.R.R. v. Odum, 133 Miss. 543, 551, 98 So. 60, 61 (1923).

[78] Fisher v. Daniels, 252 Miss. 662, 668, 173 So. 2d 908, 913-14 (1965).

[79] Fournier v. United States, 220 F. Supp. 752, 755 (S.D. Miss. 1963).

dant's best line of defense logically would be to establish that accidents such as the plaintiff's do in fact happen in spite of all reasonable precautions. Such a showing

> tends to undercut the very premise on which res ipsa loquitur rests. Where this is found to be the case by the courts on the basis of common experience . . . it precludes application of the doctrine.[80]

If available expert evidence indicates that such an accident happens as often as not despite the exercise of due care, such evidence should be introduced. The defendant must consider, however, that an expert may be essential to the plaintiff's case and that the plaintiff may be unable—financially or otherwise—to acquire one. Thus, unless the defendant knows the expert's testimony will strongly favor his cause, calling the expert as a witness could provide the plaintiff's needed expert testimony.[81] In addition, if the challenged enterprise's social utility is already questionable, the defendant should avoid such expert testimony since it may accentuate the dangerous propensities of the enterprise generally and induce judicial hostility.[82]

b. Lack of Notice

In a proper case, the defendant may overcome the inference of negligence arising under the doctrine by showing that, prior to the injury, he had thoroughly inspected the injuring instrumentality or that he was not negligent with respect to the plaintiff's specific injury.[83] Res ipsa, however, will not be rendered inapplicable merely because the defendant does not know or cannot prove what actually transpired with respect to the plaintiff's injury.[84] Cases exist, however, which cloud the issue.

In *Pongetti v. Spraggins*,[85] for example, the plaintiff's car collided at night with a calf owned by the defendant. At trial, the plaintiff offered no direct evidence that the defendant negligently permitted the calf to run loose on the highway.[86] On the other hand, the defendant

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[80] 2 F. HARPER & F. JAMES, *supra* note 24, § 19.12, at 1106.

[81] *See, e.g.*, MISS. CODE ANN. § 13-1-226(b)(4) (Supp. 1975) (discovery of opponent's experts). *See generally* Pyle, Ott & Rumfelt, *Mississippi Rules of Discovery*, 46 MISS. L.J. 681, 693-95 (1975); Lyons, *Mississippi Discovery Act*, in STATE COURT DISCOVERY 105-06 (Miss. Law Inst. 1975).

[82] Fricke, *The Use of Expert Evidence in Res Ipsa Loquitur Cases*, 5 VILL. L. REV. 59, 75 (1959).

[83] Gates v. Greyhound Corp., 197 F. Supp. 341, 345 (S.D. Miss. 1960).

[84] Haasman v. Pacific Alaska Air Express, 100 F. Supp. 1, 2 (D. Alas. 1951), *aff'd sub nom.*, Des Marais v. Beckman, 198 F.2d 550 (9th Cir. 1952).

[85] 215 Miss. 397, 61 So. 2d 158 (1952).

[86] *Id.* at 407, 61 So. 2d at 160.

testified that (1) the calf was on the highway without his knowledge, (2) he had used reasonable care to restrain the calf, and (3) the calf had escaped without fault or negligence on his part.[87] On the basis of these circumstances, the Mississippi Supreme Court ruled that the defendant's evidence sufficed to overcome any inference of negligence that might have arisen from the mere proof of the calf's unsupervised presence on the highway. In so ruling, the court reasoned that

> to exculpate himself from blame, [the defendant] was not required to show how the calf had escaped . . . or why the calf was at large on the highway. These facts were perhaps as completely unknown to the defendant as to the plaintiff. The defendant was only required to show . . . that he had exercised reasonable care to prevent the calf from escaping from the . . . enclosure, and that he was not at fault in permitting the calf to escape or be at large on the highway.[88]

At first glance, *Pongetti* would appear to allow a defendant, in certain instances, to escape the inference of negligence by showing that he was without "notice or knowledge" of the facts relating to the plaintiff's injury.[89] Although not a res ipsa case, *Cone v. Virginia-Carolina Chemical Corp.*[90] further illustrates this principle. In that case, a farmer brought an action for injuries he suffered when his hands came in contact with a commercial fertilizer manufactured by the defendant.[91] The evidence was deemed insufficient to submit the question of the defendant's liability to the jury absent proof that the defendant knew either that the fertilizer was improperly prepared or in fact dangerous, or how farmers were applying the fertilizer.[92]

c. *Open-and-Obvious Danger*

The doctrine of res ipsa loquitur does not apply if the danger complained of was entirely open and visible before the accident.[93] Regardless of whether a products liability case proceeds upon a negligence or implied warranty theory, the open-and-obvious nature of the injurious defect or danger has a direct bearing on the liability *vel non* of the

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[87] *Id.* at 414, 61 So. 2d at 163.

[88] *Id.*

[89] *See also* Early-Gary, Inc. v. Walters, 294 So. 2d 181, 187 (Miss. 1974) (restaurant operator not negligent in placing defective catsup bottle on table where defect not known to operator and could not be discovered by visual inspection).

[90] 178 Miss. 816, 174 So. 554 (1937).

[91] *Id.* at 820, 174 So. at 554.

[92] *Id.* at 823, 174 So. at 555.

[93] Wallace v. J. C. Penney Co., 236 Miss. 367, 374, 109 So. 2d 876, 878-79 (1959); Daniel v. Jackson Infirmary, 173 Miss. 832, 838, 163 So. 447, 448 (1935).

defendant.[94] Under general negligence principles, the doctrine is inapplicable if the danger was open and visible.[95] Likewise, if the theory is implied warranty and the danger or defect was open and obvious, any duty owed by the manufacturer to the ultimate user is fulfilled when the manufacturer has done everything necessary to ensure that the product will function properly for its designed purpose.[96] Since the open-and-obvious-danger rule can absolutely preclude a plaintiff from relying upon res ipsa, the court's application of such a rule may be eroding the basis of Mississippi's comparative negligence statute.[97]

In products liability cases predicated upon a theory of negligent design, one relevant criterion in determining the reasonableness of the product's design is the open-and-obvious nature of the alleged danger.[98] Similarly, in those cases predicated upon a negligent failure to warn, where the dangerous condition is shown to be open and obvious to the user, the manufacturer has no obligation to warn.[99] In this context, however, the open-and-obvious-danger rule has been criticized because it fails to consider whether the plaintiff appreciated the danger.[100] In light of such criticisms, the courts may soon recognize a general duty to warn consumers of obviously defective products if the likelihood or severity of harm is great and the burden of giving such a warning is slight.[101]

d. Lack of Exclusive Control

The prerequisite that the instrumentality causing an accident be within the defendant's exclusive control has been liberally construed by the Mississippi Supreme Court. Illustrative is the court's statement in *Johnson v. Coca-Cola Bottling Co.*[102] that a defendant who is

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[94] *See* Jones v. Babst, 323 So. 2d 757, 759 (Miss. 1975).

[95] Wallace v. J. C. Penney Co., 236 Miss. 367, 374, 109 So. 2d 876, 878-79 (1959).

[96] Harrist v. Spencer-Harris Tool Co., 244 Miss. 84, 94-95, 140 So. 2d 558, 561-62 (1962).

[97] Maraist & Barksdale, *supra* note 2, at 146.

[98] Ward v. Hobart Mfg. Co., 450 F.2d 1176, 1182 (5th Cir. 1971).

[99] Harrist v. Spencer-Harris Tool Co., 244 Miss. 84, 94-95, 140 So. 2d 558, 561-62 (1962).

[100] Friedman, *Liability of Manufacturers*, in PRODUCTS LIABILITY 1, 4 (Miss. Law Inst. 1973).

[101] *See* Pike v. Frank G. Hough Co., 2 Cal. 3d 465, 467 P.2d 229, 234, 85 Cal. Rptr. 629, 635 (1970), holding that even if a purchaser or user of a product has knowledge that the product lacks a safety device or guard, the jury should be allowed to decide whether reasonable care requires a feasible precaution to be taken by the defendant manufacturer. *See generally* Maraist, *New Frontiers in Products Liability*, in PRODUCTS LIABILITY 129, 124 (Miss. Law Inst. 1973).

[102] 239 Miss. 759, 125 So. 2d 537 (1961).

> sought to be charged with negligence under the doctrine of *res ipsa loquitur* . . . is only required to have control of the instrumentality at the time of the *negligent act* which gives rise to the injury and not necessarily at the time of the accident to the plaintiff.[103]

But if the doctrine is extended to situations in which the defendant was not in exclusive control of the instrumentality at the time of the injury, could the doctrine's application effectively impose a form of absolute liability upon the defendant in the guise of an almost insuperable burden of rebuttal?[104] Thus extended, the doctrine becomes more a substantive rule of law than a rule of circumstantial evidence.[105] Obviously, the longer a defendant was without actual control of the instrumentality, the more likely the possibility that some intervening agency caused the injury. Moreover, the more remote in time and distance the defendant is with respect to the time of the actual injury, the less likely he will be to have ready access to rebuttal or explanatory evidence.[106] If the plaintiff in such a case is unable to establish that the instrumentality was not in the same condition at the time of the injury as when it left the defendant's actual control, a jury will be justified in finding for the defendant.[107]

Depending upon the type of defendant involved, *e.g.*, a lessor who has delegated management and control of the injuring instrumentality to his lessee, the requirement of exclusive management and control may be applied more restrictively.[108] Specifically, assuming the injury-causing instrumentality is not within the defendant's exclusive possession and control at the time of the accident, the doctrine may apply more readily in "original package" or "sealed container"[109] cases or where the injury results from the "first use" of the instrumentality or product.[110] In such cases, the defendant should be in a superior position to know or ascertain the cause of the plaintiff's injury because of his control and management of the instrumentality at the time of the negligent act or omission. One commentator, however, has observed that

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[103] *Id.* at 765-66, 125 So. 2d at 539.

[104] 59 MICH. L. REV. 136, 138 (1960).

[105] *Id.* at 138.

[106] *Id.*

[107] Stevens v. Picayune Coca-Cola Bottling Co., 224 Miss. 871, 874, 82 So. 2d 453, 454 (1955).

[108] *Cf.* Lollar v. East Miss. Oil Co., 234 Miss. 295, 298, 106 So. 2d 65, 66 (1958) (res ipsa loquitur not applicable where lessor neither had control of grease lift nor control of its operation).

[109] *See generally* Kroger Grocery Co. v. Lewelling, 165 Miss. 71, 145 So. 726 (1933).

[110] Cowan & Malinak, *Res Ipsa Loquitur—The Application of the Doctrine to Products Liability Cases*, 31 INS. COUNSEL J. 71, 76-77 (1964). *See generally* Parker v. Ford Motor Co., 331 So. 2d 923 (Miss. 1976).

when this element of control and management is not present at the time of the plaintiff's injury, the basis of the doctrine is removed.[111] Such a position seems reasonable in light of the fact that the plaintiff in a res ipsa case has no burden of showing that neither he nor some third party had the opportunity to tamper with or otherwise materially affect the injuring instrumentality.[112]

Finally, in *Denman v. Denman*,[113] the doctrine was held inapplicable in an action by a passenger against his driver's estate for injuries received in a two-car collision.[114] The court reasoned that since the driver of the first car had been speeding, the driver of the second car—the plaintiff's driver—could not have been the sole, proximate cause of the collision. That is, the driver of the second car had no control over the first car.[115] Thus, res ipsa will not apply in the face of proof that the injury might have occurred because of the concurrent negligence of two or more persons, one of whom was not under the defendant's management or control.[116]

4. Use of Discovery Procedures

The availability of discovery devices under the Mississippi Rules of Discovery raises the question of whether application of the doctrine is precluded because the plaintiff, by virtue of their existence, is equally able to discover the cause of the injury or accident. In *Menth v. Breeze Corp.*,[117] a leading case on this point, the defendant contended that res ipsa was inapplicable because the plaintiff made no attempt to seek additional evidence by available means of discovery. Rejecting this contention, the New Jersey Supreme Court held:

> We see no merit in this attempt to circumvent the application of the rule and therefore hold that plaintiff's failure to use such pre-trial procedures in an effort to elicit specific acts of defendant's negligence does not bar the application of the *res ipsa loquitur* rule if its other requirements are satisfied. A contrary conclusion would tend to undermine the effectiveness of the rule.[118]

A similar argument was raised by the defendant in *Bone v. General*

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[111] Reed, *supra* note 30, at 5.

[112] Coast Coca-Cola Bottling Co. v. Bryant, 236 Miss. 880, 883, 112 So. 2d 538, 539 (1959).

[113] 242 Miss. 59, 134 So. 2d 457 (1961).

[114] *Id.* at 63, 134 So. 2d at 461.

[115] *Id.*

[116] *Id.* at 69-70, 134 So. 2d at 461.

[117] 73 A.2d 183 (N.J. 1950).

[118] *Id.* at 187.

Motors Corp.[119] The court in *Bone*, however, simply rejected the contention that the state discovery procedures afforded the plaintiff an equal opportunity to discover the cause of the accident.[120]

If the plaintiff chooses to utilize discovery to obtain admissions of a party opponent,[121] the results of such discovery may limit the plaintiff's proof to specific acts of negligence since a complete factual development might remove the basis for applying the doctrine. For example, in *Dees v. Pace*,[122] a physician allegedly stated prior to trial that he had made a mistake in the performance of a hysterectomy. The court held that if construed as an admission, such a statement would constitute evidence of a specific act of negligence, depriving the plaintiff of a basis for applying res ipsa.[123]

The foregoing discussion must, however, be considered in light of the restriction that res ipsa cannot

> excuse or dispense with definite proof of material facts which are tangible and are capable of direct and specific evidence, as much within the power of the plaintiff to produce as within the power of the defendant.[124]

In *Crawford v. Worth*,[125] for example, the plaintiff had brought a personal injury action based upon burns allegedly suffered while showering in the defendant's motel.[126] Affirming a rejection of the plaintiff's res ipsa instruction, the Fifth Circuit, applying Mississippi law, stated that the

> plaintiff was not disabled in any demonstrated way from testing the specific physical capabilities of the defendant's water system and . . . the issue was put to the jury to resolve a specific fact conflict as to whether excessively heated water caused plaintiff's injuries . . . .[127]

Crawford would thus appear to cast considerable doubt upon both the

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[119] 322 S.W.2d 916 (Mo. 1959).

[120] *Id.* at 922. The Mississippi Supreme Court cited Warner v. Terminal R.R. Ass'n, 257 S.W.2d 75 (Mo. 1953), which held that a plaintiff in a res ipsa case

> is not required to present evidence overthrowing every reasonable theory of nonliability on the part of the defendant. If a plaintiff in such a case were required to produce evidence which would exclude every reasonable theory but that of the negligence of the defendant, the doctrine would be annihilated.

Id. at 79.

[121] *See* Pyle, Ott & Rumfelt, *supra* note 81, at 748-63.

[122] 257 P.2d 756 (Cal. 1953).

[123] *Id.* at 759. *But see* McGhee v. United States, 75 F. Supp. 76 (S.D.N.Y.), *modified on other grounds*, 165 F.2d 287 (2d Cir. 1947).

[124] Crawford v. Worth, 447 F.2d 738, 742 (5th Cir. 1971).

[125] 447 F.2d 738 (5th Cir. 1971).

[126] *Id.* at 739.

[127] *Id.* at 742. *See generally* MISS. CODE ANN. § 13-1-234 (Supp. 1976).

utility of discovery procedures and subsequent attempts to rely upon res ipsa loquitur when they are employed.[128]

III. Application of the Doctrine

A. *Specific Factual Settings*

1. Explosions and Fires

While no Mississippi blasting case has been found in which res ipsa loquitur was invoked,[129] the use of explosives arguably should not cause damage to adjacent property in the absence of negligence. Thus, assuming satisfaction of the additional prerequsites, the doctrine should apply in cases involving such damage.[130] And although cases involving dynamite blasting caps present no particular problem with respect to the doctrine's applicability,[131] the existence of intervening acts or the passage of time may warrant a finding that the condition of the product was altered after leaving the manufacturer's hands.[132] Beyond the realm of explosive devices, the doctrine has been applied to the explosion of a can

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[128] *See* D. Louisell & H. Williams, Trial of Medical Malpractice Cases § 15.01, at 464 (1972); *cf.* Cleminshaw v. Beech Aircraft Corp., 21 F.R.D. 300 (D. Del. 1957). In *Cleminshaw*, plaintiff instituted a civil action as trustee of her husband's estate against an aircraft corporation. An interrogatory was served upon plaintiff inquiring as to her reliance upon res ipsa loquitur. Plaintiff refused to respond since an answer would require a legal conclusion she was not qualified to draw. In ruling that plaintiff need not reply to the interrogatory, the court stated:

> Clearly, the only way plaintiff can adequately ascertain the answer to this interrogatory is to consult with her attorney. Although, as the court has noted, present plaintiff may not confine her answers to personal knowledge, this should not be interpreted as sanctioning a device to avoid the rule of *Hickman v. Taylor*. At the least, what defendant pursues must be deemed the work product of counsel; for it is, indeed, difficult to conceive of a client not learned in the law suggesting to counsel the legal doctrine of res ipsa loquitur.

Id. at 302 (footnote omitted).

[129] *See* 21 Miss. L.J. 289, 291 (1950). *But cf.* Bridges v. Texaco, Inc., 242 Miss. 705, 714-15, 136 So. 2d 595, 598-99 (1962) (evidence supported prima facie case of defendant's negligence in setting off dynamite charges without warning owner of nearby chicken houses, thereby frightening chickens and causing decreased egg production).

[130] 2 S. Speiser, The Negligence Case—Res Ipsa Loquitur § 17:4, at 49-50 (1972); *see* Capital Transp. Co. v. Segrest, 254 Miss. 168, 187, 181 So. 2d 111, 119 (1965). *But see* Caramagno v. United States, 37 F. Supp. 741, 743 (D. Mass. 1941) (doctrine not applicable to actions for damages allegedly caused by negligent blasting). *See generally* Continental Ins. Co. v. Harrison County, 153 F.2d 671, 676-77 (5th Cir. 1946) (one who uses dangerous agency of dynamite must exercise highest degree of care to prevent injury to another).

[131] *See* Dement v. Olin-Mathieson Chem. Corp., 282 F.2d 76, 81-82 (5th Cir. 1960); Mahoney v. Hercules Powder Co., 221 Cal. App. 2d 353, 34 Cal. Rptr. 468, 472 (1963).

[132] *See* Doss v. Apache Powder Co., 430 F.2d 1317, 1321 (5th Cir. 1970) (accidental explosion of two and one-half-year-old sticks of dynamite).

of Drano[133] and to the explosion of a tire being changed by a plaintiff.[134]

The Mississippi Supreme Court has consistently declined to apply res ipsa loquitur in cases involving fire loss. For example, in *Milner Enterprises, Inc. v. Jacobs*,[135] the court concluded that the doctrine was not available to a plaintiff whose gas-filled airplane was destroyed by a sudden fire in the defendant's hangar.[136] To be sure, the court traditionally has adhered to the idea that the plaintiff in such a situation has the burden of showing the defendant's negligence and that such negligence proximately caused the damage. The fire itself is apparently an insufficient showing of negligence.[137]

2. Accidents Involving Means of Transportation

The question of the doctrine's applicability has arisen frequently in the context of automobile accidents. An examination of Mississippi case law, however, reveals that efforts to invoke the doctrine in such situations have met with only limited success.[138] Arguably, in automobile accident cases against multiple defendants, courts should relax the exclusive control requirement, particularly where a strict application might defeat the doctrine's purpose and policy.[139] And if there is a clear probability that one or more of several defendants were negligent, and if the plaintiff is unable to specify which is responsible for his injury,

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[133] Moore v. Jewel Tea Co., 253 N.E.2d 636, 647-48, *aff'd*, 263 N.E.2d 103, 108 (Ill. 1970).

[134] Ewer v. Goodyear Tire & Rubber Co., 480 P.2d 260, 264-65 (Wash. 1971).

In an exploding-tire or tire-changing case, the plaintiff, in order to apply the doctrine, must, inter alia, account for the product's condition after leaving the manufacturer's control and show that he employed proper methods in his use of the product. Failure to do so may confront the plaintiff with recovery-precluding defenses. *See, e.g.*, Turner v. Big Four Automotive Equip. Corp., 511 F.2d 133, 135-36 (5th Cir. 1975) ("second accident" defense).

[135] 207 So. 2d 85 (Miss. 1968).

[136] *Id.* at 91.

[137] *See, e.g.*, Bush v. Laux, 232 Miss. 63, 65, 97 So. 2d 923, 924 (1957) (landlord had burden of showing tenant's negligence and that such negligence was proximate cause of fire; doctrine not applicable); Mississippi Power & Light Co. v. Sumner Gin Co., 156 Miss. 830, 838, 127 So. 284, 286 (1930) (evidence with respect to negligence in operating generator with hot bearing insufficient for submission to jury on doctrine of res ipsa loquitur). *See generally* Annot., 8 A.L.R. 3d 974 (1966).

[138] *See, e.g.*, Glover v. Boggan, 203 So. 2d 486, 488 (Miss. 1967) (not applicable to two-car collision); Johnson v. Foster, 202 So. 2d 520, 524 (Miss. 1967) (applicable to two-car collision; exclusive control requirement relaxed in manner consistent with doctrine's purpose and policy); Denman v. Denman, 242 Miss. 59, 69-70, 134 So. 2d 457, 461 (1961) (not applicable to two-car collision on rainy evening); Pongetti v. Spraggins, 215 Miss. 397, 412-13, 61 So. 2d 158, 163 (1952) (not applicable to collision with calf in highway).

[139] *See generally* 2 S. SPEISER, *supra* note 130, § 26.2, at 302.

the doctrine should be applied.[140]

The recent case of *Baker v. Ford Motor Co.*,[141] a strict liability case, is worthy of consideration at this juncture because of the court's statements with respect to res ipsa loquitur. The plaintiff, permanently injured when his automobile brakes failed, alleged both the defective nature of the brakes and a failure to inspect them after factory recall.[142] The trial court granted directed verdicts in favor of both the manufacturer and retailer defendants.[143] On appeal, the Mississippi Supreme Court treated the case as one based upon the theory of strict liability in tort, although the early part of its opinion appeared to apply negligence principles.[144] Significantly, the plaintiff had contended that when a specific causal connection cannot be shown, "the doctrine of *res ipsa loquitur* should be applied where the facts are so constituted that an 'inference of causation' naturally springs from the facts shown."[145] The court, while clearly stating that the case was based upon strict liability in tort, did not reject the implication that the doctrine might apply in such a case. By failing to address itself directly to this contention, the court, at least implicitly, condoned the doctrine's use.

The plaintiff in a strict liability case is required to prove the existence of a defect in the product and mere proof of damage following the product's use will not establish the manufacturer's liability.[146] In the same light, it has been held that when the plaintiff relies upon strict liability, res ipsa cannot be employed to make the requisite showing of a defect in the product.[147] But to the extent that it allows reasonable inferences to be drawn from circumstantial evidence, the doctrine's un-

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[140] *See* Denman v. Spain, 242 Miss. 431, 439, 135 So. 2d 195, 197 (1961) (no clear probability that one or more defendants were negligent; "verdicts cannot be based on possibilities").

[141] 317 So. 2d 51 (Miss. 1975).

[142] *Id.* at 52.

[143] *Id.*

[144] The court referred ambiguously to the plaintiff's burden

> to affirmatively show, by direct or circumstantil [sic] evidence, that the defendants violated some duty owed to the plaintiff, and that the failure to perform the duty resulted in injury to the plaintiff.

Id.

[145] *Id.* at 53-54. *See also* Wilburn v. Gordon, 209 Miss. 27, 48-50, 45 So. 2d 844, 846-47 (1950).

[146] *See, e.g.*, William Cooper & Nephews, Inc. v. Pevey, 317 So. 2d 406, 409 (Miss. 1975); Baker v. Ford Motor Co., 317 So. 2d 51, 56 (Miss. 1975) (plaintiff, despite reliance on doctrine, still must show actual defect and proximate cause).

[147] McCurter v. Norton Co., 263 Cal. App. 2d 402, 69 Cal. Rptr. 493, 496 (1968). *See also* Snider v. Bob Thibodeau Ford, Inc., 202 N.W.2d 727, 730 (Mich. 1972); Henningsen v. Bloomfield Motors, Inc., 32 N.H. 358, 161 A.2d 69, 75 (1960); Coca-Cola Bottling Co. v. Hobart, 423 S.W.2d 118, 124-25 (Tex. Civ. App. 1969).

derlying principle should apply in a strict liability context.[148] If the strict liability plaintiff can demonstrate proper use of the product and negate other possible causes of failure after the product left the manufacturer's control, an inference similar to that available under res ipsa may establish a defect.[149]

Although the Mississippi Supreme Court has not foreclosed the doctrine's application in a proper case, the Fifth Circuit, applying Mississippi law, has refused to apply res ipsa in cases of tire blowouts. For example, in *Edwards v. Sears, Roebuck & Co.*,[150] the plaintiff's decedent was killed in an automobile crash allegedly caused by defective Michelin tires sold by the defendant.[151] The trial judge had instructed the jury that the mere fact of the accident's occurrence did not constitute evidence of negligent conduct on the part of the defendants and that no presumption of negligence was created.[152] The court of appeals agreed and, noting that "the Mississippi Supreme Court has consistently held that 'the doctrine of res ipsa should be strictly limited and cautiously applied,'"[153] ruled that res ipsa was not applicable.[154] Apparently, the mere fact of a blowout, with no evidence as to the use and maintenance history of the tire, is insufficient to create an inference of negligence.[155] A contrary rule, however, prevails in the context of common carriers.[156] The rationale for such a distinction may be found in the duty owed by a common carrier to its passengers to exercise the highest degree of care and precaution for their safety.[157]

Finally, it should be noted that res ipsa loquitur has been utilized in a variety of cases involving injuries or death in aviation accidents.[158]

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[148] *See* Coca-Cola Bottling Co. v. Hobart, 423 S.W.2d 118, 124 (Tex. Civ. App. 1969).

[149] *See, e.g.*, Franks v. National Dairy Prod. Corp., 282 F. Supp. 528, 530-31 (W.D. Tex. 1968), *aff'd*, 414 F.2d 682 (5th Cir. 1969); Jagmin v. Simonds Abrasive Co., 211 N.W.2d 810, 817 (Wis. 1973).

[150] 512 F.2d 276 (5th Cir. 1976).

[151] *Id.* at 279-80.

[152] *Id.* at 287 n.15.

[153] *Id.* at 287, *quoting* Clark v. Vardaman Mfg. Co., 249 Miss. 42, 44, 162 So. 2d 857, 858 (1964).

[154] 512 F.2d at 287; *accord*, Markwell v. General Tire & Rubber Co., 367 F.2d 748, 750 (7th Cir. 1966); United States Rubber Co. v. Bauer, 319 F.2d 463, 468 (8th Cir. 1963); Senter v. B. F. Goodrich Co., 127 F. Supp. 705, 708-09 (D. Colo. 1954).

[155] 1 S. SPEISER, *supra* note 45, § 12:18, at 485.

[156] *See, e.g.*, Greyhound Corp. v. Brown, 113 So. 2d 916, 919 (Ala. 1959); Jianou v. Pickwick Stages Sys., 111 Cal. App. 754, 296 P. 108, 109 (1931); Brisolara v. Caddo Transfer & Warehouse Co., 127 So. 57, 58 (La. App. 1930).

[157] Teche Lines v. Keyes, 187 Miss. 780, 788, 193 So. 620, 621 (1940).

[158] *See, e.g.*, Becker v. American Airlines, Inc., 200 F. Supp. 839, 840 (S.D.N.Y. 1961) (doctrine applicable despite plaintiff's attempts to show possible causes of accident). *See generally* 1 S. SPEISER, *supra* note 45, at § 10:1. The court, however, must find that the prerequisites for the doctrine's application are present. *See* Kelly v. American Airlines,

In such cases, the element of exclusive control has proven to be a particularly crucial consideration in determining the doctrine's applicability.[159] Nevertheless, where a specific defect or malfunction is shown to be responsible for the crash of the aircraft, an inference of negligence is permissible.[160]

3. Products for Human Consumption

In the context of sealed packages of food and bottled beverages, the vendor of such products is required to exercise the highest degree of care to prevent injury to the consuming public. Accordingly, res ipsa loquitur has been deemed applicable to a variety of cases involving contaminated food and beverages.[161] For example, in *Coast Coca-Cola Bottling Co. v.*

Inc., 372 F. Supp. 1214, 1215-16 (N.D. Tex.), *aff'd*, 508 F.2d 1379 (5th Cir. 1974) (doctrine not applicable in action by passenger for injuries allegedly sustained when thrown about restroom cabin by "bump" in air).

[159] *See* Northwest Airlines, Inc. v. Rowe, 226 F.2d 365, 370-71 (8th Cir. 1955). *Compare* Campbell v. First Nat'l Bank, 370 F. Supp. 1096, 1098 (D.N.M. 1973) (insufficient proof of requisite control over airplane with respect to mechanical condition as well as manner of flight leading to crash) *with* Higginbotham v. Mobil Oil Corp., 357 F. Supp. 1164 (W.D. La. 1973), *aff'd in part, rev'd in part*, 545 F.2d 422 (5th Cir. 1977) (doctrine applicable to helicopter crash into Gulf of Mexico where defendant was shown to have exclusive management and control of helicopter at time of flight).

[160] *See* Raritan Trucking Corp. v. Aero Commander, Inc., 458 F.2d 1106, 1110-11 (3d Cir. 1972) (landing gear malfunction); Moore v. Douglas Aircraft Co., 282 A.2d 625, 628 (Del. Super. 1971) (breakage of yoke and sling fixture holding aircraft engine).

[161] *See, e.g.*, Coast Coca-Cola Bottling Co. v. Bryant, 236 Miss. 880, 883, 112 So. 2d 538, 540 (1959) (roach in beverage bottle); Laurel Coca Cola Bottling Co. v. Hankins, 222 Miss. 297, 307, 75 So. 2d 731, 734 (1954) ("acid iron earth water" in bottled beverage); Coca Cola Bottling Works, Inc. v. Petty, 190 Miss. 631, 638, 200 So. 128, 130 (1941) (foreign substance in bottle); Pillars v. R. J. Reynolds Tobacco Co., 117 Miss. 490, 494, 78 So. 365, 366 (1918) (contamination of tobacco plug); Jackson Coca-Cola Bottling Co. v. Chapman, 106 Miss. 864, 869, 64 So. 791, 791 (1914) (foreign substance in bottle). *But see* Goodwin v. Misticos, 207 Miss. 361, 389, 42 So. 2d 397, 407 (1949) (not applicable in action against restaurant operator for customer's death allegedly caused by ptomaine poisoning which resulted from eating defendant's corned beef); Johnston v. Swift & Co., 186 Miss. 803, 812, 191 So. 423, 425 (1939) (not applicable to sickness allegedly caused by eating defendant's sausage).

In a somewhat analogous context, res ipsa generally has been held applicable where injuries result from the use of drugs and medicines, both sealed and unsealed. *See, e.g.*, Berry v. American Cyanamid Co., 341 F.2d 14, 20 (6th Cir. 1965) (since there is common experience relative to use of oral polio vaccine, validity of res ipsa count in complaint should be determined in light of such evidence); Oresman v. G. D. Searle & Co., 321 F. Supp. 449, 454-55 (D.R.I. 1971) (although defendant oral contraceptive manufacturer relinquished control of drug to distributor, plaintiff was not precluded from relying on res ipsa loquitur, especially where drug was in sealed container). *See generally* 2 S. SPEISER, *supra* note 130, at § 28:18; Comment, *Strict Liability and Allergic Drug Reactions*, 47 MISS. L.J. 526, 535-36 (1976) (discussion of doctrine's inapplicability to physician's liability for injuries resulting from allergic drug reactions).

Bryant,[162] the plaintiff sought damages for an illness allegedly precipitated by drinking from a soft drink bottle which contained a roach.[163] The defendant bottling company, relying upon a decision of the Utah Supreme Court,[164] argued that res ipsa had no application in the case.[165] The court, however, disageed and held that

> "[i]f this [foreign] matter was in [the] bottle, the jury, under the maxim res ipsa loquitur, were warranted in believing that it got into the bottle through the negligence of the [defendant's] employees."[166]

Likewise, in *Pillars v. R. J. Reynolds Tobacco Co.*,[167] a tobacco manufacturer was ordered to pay damages to a consumer who contracted ptomaine poisoning from chewing a plug of the defendant's tobacco which contained a human toe.[168] Liability such as that imposed in *Bryant* and *Pillars*, however, is not limitless. For example, the Mississippi Supreme Court has consistently found the doctrine inapplicable to cases of germs or bacteria in food.[169]

In this context, it is noteworthy that distributors have enjoyed a relatively greater insulation from liability than other members of the distributive chain.[170] This state of affairs has prompted one commentator to note that

> [t]he distributor is generally free from negligence, and the restrictive privity requirements of the Uniform Commercial Code usually bar most suits against him under that theory. Sounder reasoning indicates that the distributor, as a link in the chain of defendants who have placed the product in the stream of commerce, should be held strictly liable in tort, but the courts have vacillated on this point. The distribu-

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[162] 236 Miss. 880, 112 So. 2d 538 (1959).

[163] After consuming a portion of the beverage, plaintiff became nauseated and vomited several times and continued in that condition for "a considerable period of time." *Id.* at 882, 112 So. 2d at 539.

[164] In Jordan v. Coca Cola Bottling Co., 117 Utah 578, 218 P.2d 660, 664-65 (1950), the Utah court required the plaintiff to prove that no third party had an opportunity to tamper with a bottle containing a foreign substance. *See* 236 Miss. at 883, 112 So. 2d at 539.

[165] 236 Miss. at 883, 112 So. 2d at 539.

[166] *Id.* at 540, *quoting* Coca Cola Bottling Works v. Petty, 190 Miss. 631, 638, 200 So. 128, 130 (1941).

[167] 117 Miss. 490, 78 So. 365 (1918).

[168] *Id.* at 500, 78 So. at 366.

[169] *See* Goodwin v. Misticos, 207 Miss. 361, 389, 42 So. 2d 397, 407 (1949); Johnston v. Swift & Co., 186 Miss. 803, 812-13, 191 So. 423, 425 (1939).

[170] *See, e.g.*, Pillars v. R. J. Reynolds Tobacco Co., 117 Miss. 490, 500, 78 So. 365, 366 (1918) (both manufacturer and distributor sued but only manufacturer held liable); *cf.* Kroger Grocery Co. v. Lewelling, 165 Miss. 71, 85, 145 So. 726, 727-28 (1933) (retailer not liable under implied warranty theory).

> tor nevertheless, has sometimes been reached for tortious misrepresentations, or, where he has performed some work on the product, for negligence.[171]

The question of res ipsa loquitur's applicability to consummables has arisen tangentially in the context of exploding bottles. The Mississippi Supreme Court, in *Johnson v. Coca-Cola Bottling Co.*,[172] held that proof of the bottle's explosion shifted to the defendant the burden of going forward with the proof and required him to dispel any inference of negligence.[173] According to the court, the test for liability then is simply whether the plaintiff has shown a lack of negligence—by himself and others—in handling the bottle.[174]

Later, however, the court in *Falstaff Brewing Corp. v. Williams*,[175] an action for injuries sustained by a cafe employee as the result of a beer bottle explosion, somewhat surprisingly emasculated *Johnson*. The court stated: "We are inclined to feel that the rule of strict liability in tort is more applicable in exploding bottle cases."[176] Further confusion was added by the language in *Sam Shainberg Co. v. Barlow*,[177] which, in recalling the facts of *Falstaff*, seemed to read into that case a theory of negligence rather than of strict liability in tort.[178] Arguably, the court in *Falstaff* recognized the inference of causation represented by the doctrine, while simultaneously stating that it is not applicable to strict liability cases.[179]

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[171] Maraist, *supra* note 101, at 138 (footnote omitted). With regard to the retailer's liability to the buyer and other persons for defective products, the case of Sam Shainberg Co. v. Barlow, 258 So. 2d 242 (Miss. 1972) has been construed to place Mississippi in a distinct minority since in almost all other jurisdictions

> the retailer has to stand behind the product he sells, and the circumstances that he bought from a reputable source, that the manufacturer had a good reputation, that the product was not altered in any way by the retailer is of no avail as respects his liability to parties injured by the defective product.

Pedrick, *Retailer's Product Liability in Mississippi: Where the Living Is Easier*, in PRODUCTS LIABILITY 13, 13 (Miss. Law Inst. 1973).

[172] 239 Miss. 759, 125 So. 2d 537 (1960).

[173] *Id.* at 773, 125 So. 2d at 543. In so ruling, the court distinguished Wheeler v. Laurel Bottling Works, 111 Miss. 442, 448, 71 So. 743, 745 (1916), which had held that no inference of negligence arose from the mere explosion of a single bottle manufactured by the defendant. 239 Miss. at 769, 125 So. 2d at 541.

[174] 239 Miss. at 773, 125 So. 2d at 543.

[175] 234 So. 2d 620 (Miss. 1970).

[176] *Id.* at 623.

[177] 258 So. 2d 242, 246 (Miss. 1972).

[178] Indeed, the court observed that in *Falstaff*, there was evidence that the distributor was negligent in handling the cases of bottled beer which the distributor transported in its trucks from Falstaff's plant in [Louisiana] to the distributor's warehouse in [Mississippi].

Id.

[179] According to Maraist and Barksdale, the ruling in *Falstaff*

4. Products Used in the Course of a Trade or Business

If the usual prerequisities for application of the doctrine are present, res ipsa loquitur may be utilized in situations involving products used in the course of a trade or business. In this context, the doctrine has found application in cases involving industrial machinery, construction materials and supplies,[180] and the use of agricultural chemicals.[181] For example, in *Bustamante v. Carborundum Co.*,[182] a railroad employee was permitted to proceed upon a res ipsa theory in asserting a claim for damages against his employer arising from the disintegration of a "grinding wheel" on a piece of railroad equipment.[183] And, in *Eaton*

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indicates a confounding of policy, and proof. Strict liability decrees that as a matter of policy, without proof of wrongful act, a manufacturer of a product may be held liable for the damages caused by some quality or condition of the product. Whether the liability sought to be imposed is strict or through negligence, there must be in either event a showing that the product caused the injury. *Res ipsa loquitur* is a doctrine of the strength of proof which dictates, among other things, when there exists a permissible inference of causation. If the theory of the case is negligence, then proof that (a) the conduct of the injured party did not contribute to the accident, and (b) the instrumentality which did in fact contribute to the accident was within the control of the alleged wrongdoer, and (c) the accident is one which ordinarily would not occur in the absence of negligence, will give rise to an inference of both breach of duty and causation. Where the theory of the case is strict liability, either in warranty or in tort, there is no need to find breach of duty, but the presence of two of the elements of *res ipsa*—(a) and (b) above—should give rise to a reasonable inference that some quality or condition of the product did in fact cause the accident, which . . . is an essential element of any products liability case, regardless of the theory upon which it is based. The court in *Falstaff* nevertheless permitted the case to go to the jury upon proof of (a) and (b) and thus recognized the inference of causation which *res ipsa* represents while stating that *res ipsa* had no applicability in strict liability cases.

Maraist & Barksdale, *supra* note 2, at 188 (footnote omitted).

[180] *See, e.g.*, Bustamante v. Carborundum Co., 375 F.2d 688, 691 (7th Cir. 1967) (personal injury action against manufacturer of abrasive wheel); May v. Columbian Rope Co., 40 Ill. App. 2d 264, 189 N.E.2d 394, 398 (1963) (action against manufacturer of rope used in building construction).

[181] *E.g.*, Grey v. Hayes-Sammons Chem. Co., 310 F.2d 291, 298-99 (5th Cir. 1962) (action for damage to crop caused by harmful herbicide contained in sealed can of insecticide); Eaton Fruit Co. v. California Spray-Chem. Corp., 103 Ariz. 461, 445 P.2d 437, 440-41 (1968) (same); Burr v. Sherwin Williams Co., 42 Cal. 2d 682, 268 P.2d 1041, 1044 (1954) (action for damage to cotton crop allegedly caused by contaminated insecticide); Hanson v. Murray, 190 Cal. App. 2d 617, 12 Cal. Rptr. 304, 306 (1961) (action against seller of weed killer); Branco Eastern Co. v. Leffler, 173 Colo. 428, 482 P.2d 364, 367-68 (1971) (although doctrine applicable to establish prima facie case of negligence in chemical's manufacture, defendant's evidence that product not injurious if applied according to directions overcame inference arising thereunder).

[182] 375 F.2d 688 (7th Cir. 1967).

[183] The court ruled that the jury could infer negligence from the facts presented despite the defendant's evidence of due care. *Id.* at 691.

Fruit Co. v. California Spray-Chemical Corp.,[184] the court found "uncontradicted evidence" which entitled the plaintiff, whose crops had been damaged by applying the defendant's insecticide,[185] to the permissible inference of negligence under the doctrine.[186]

5. Miscellaneous Personal Injuries

The res ipsa doctrine has enjoyed frequent application in cases involving the unexplained collapse of an instrumentality within the exclusive management and control of the defendant.[187] Exemplary is *Ballenger v. Vicksburg Hardwood Co.*,[188] a 1960 decision by the Mississippi Supreme Court. In *Ballenger*, the plaintiff was injured when a log stacked at the defendant's mill rolled off the stack and struck his legs. Relying strictly upon res ipsa, plaintiff contended that "if the . . . pile of logs . . . had been properly stacked, the one of them would not have rolled off the pile and injured [him]."[189] In reversing the trial judge's grant of a peremptory instruction in favor of the defendant, the court stated that "the plaintiff's case presented an issue for the determination of the jury under the doctrine of res ipsa loquitur . . . ."[190] Specifically, proof that the instrumentality collapsed places a defensive burden on the defendant,[191] and the plaintiff should request a jury instruction that the defendant has the burden of explanation after proof of the collapse has been set forth.[192] The collapse, however, must have been, under common experience, so unusual in its occurrence that an inherent probability of the defendant's negligence exists. In the absence of this probability, the court may refuse to apply the doctrine.[193] In addition, the defendant may overcome the permissible inference supplied by the doctrine if he is able to show that (1) he thoroughly inspected the instrumentality prior to its collapse and (2) he was not otherwise negligent with respect to the plaintiff's injury.[194]

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[184] 103 Ariz. 461, 445 P.2d 437 (1968).

[185] 445 P.2d at 438.

[186] *Id.* at 441.

[187] *See, e.g.*, Gates v. Greyhound Corp., 197 F. Supp. 341, 345 (S.D. Miss. 1960) (collapse of reclining bus seat); Bloch v. Brown, 201 Miss. 653, 663-64, 29 So. 2d 665, 668-69 (1947) (defendant's party wall and building collapsed and fell upon first floor of adjoining building occupied by plaintiff); *cf.* Lollar v. East Miss. Oil Co., 234 Miss. 295, 298, 106 So. 2d 65, 66 (1958) (res ipsa not applicable to defective grease lift where lessor had control of neither apparatus nor its operation).

[188] 238 Miss. 654, 119 So. 2d 778 (1960).

[189] *Id.* at 657, 119 So. 2d at 779.

[190] *Id.* at 658, 119 So. 2d at 780.

[191] Bloch v. Brown, 201 Miss. 653, 663, 29 So. 2d 665, 668 (1947).

[192] *Id.* at 664, 29 So. 2d at 669.

[193] 2 S. SPEISER, *supra* note 130, § 18:1, at 63.

[194] Gates v. Greyhound Corp., 197 F. Supp. 341, 345 (S.D. Miss. 1960).

Cases involving injuries due to electrical shocks present yet another category of situations to which the doctrine applies.[195] The plaintiff in such a situation should be permitted to rely upon res ipsa loquitur after a showing that the injuries were caused by contact with electrical wires, appliances or equipment, and that these instrumentalities would not have caused a shock if they had been in proper condition or in their proper place. The electric company or other defendant exercising exclusive control over the instrumentalities should then be required to overcome the inference of its negligence.[196]

If one is injured by slipping and falling on another's premises, res ipsa loquitur will not apply unless the injured person can show that the cause of the injury was within the owner's management and control and that the cause indicates negligence on the owner's part.[197] The Mississippi Supreme Court has, however, indicated great reluctance to apply the doctrine to such cases.[198]

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[195] *See, e.g.*, Morgan v. Mississippi Power Co., 298 So. 2d 698, 700 (Miss. 1974) (construction worker electrocuted by company's transmission lines while erecting new poles); Gulfport & Miss. Coast Traction Co. v. Hicks, 116 Miss. 164, 173, 76 So. 873, 874 (1917) (passenger in electric car shocked while leaning against controller).

[196] 1 S. SPEISER, *supra* note 45, § 14:1, at 533-34.

> The exceedingly dangerous character of live electric wires lends force to the strict application of the doctrine of res ipsa loquitur to accidents occurring through contact with them under such circumstances; and unless the doctrine is applied, it is evident in a large number of cases that liability for the resulting injury will be escaped. It is within the power of electric companies at all times to show whether they have exercised due care in the erection and subsequent supervision and maintenance of their wires, equipment and appliances, while in many cases it would be almost impossible for the injured person to prove an actionable failure of duty in these situations.

Id. at 534-35.

[197] 2 S. SPEISER, *supra* note 130, § 27:1, at 415.

[198] *See, e.g.*, Fournier v. United States, 220 F. Supp. 752, 755 (S.D. Miss. 1963) (doctrine not applicable since invitee had materially contributed to her own injury and death by being voluntarily intoxicated at the time); Daniels v. Morgan & Lindsey, Inc., 198 So. 2d 579, 584 (Miss. 1967) (not applicable to fall on waxed asphalt tile floor); Sears, Roebuck & Co. v. Tisdale, 185 So. 2d 916, 917 (Miss. 1966) (not applicable to fall caused by stepping on gumball on department store floor); Wallace v. J. C. Penney Co., 236 Miss. 367, 374, 109 So. 2d 876, 878-79 (1959) (not applicable because danger inherent in wet, slippery store foyer was "entirely open and visible"); City of Natchez v. Cranfield, 155 Miss. 540, 546, 124 So. 656, 657 (1929) (not applicable to action against municipality for fall occurring on its street). *But cf.* Gulf Hills Dude Ranch, Inc. v. Brinson, 191 So. 2d 856, 860 (Miss. 1966) (whether three highballs consumed by patron contributed to his slip and fall on defendant's dining room floor was jury question); Williamson v. F. W. Woolworth Co., 112 So. 2d 529, 532 (Miss. 1959) (error to grant directed verdict for defendant in customer's action for injuries sustained as result of slip and fall on banana peel; evidence presented jury question as to whether peel was dropped by one for whom defendant was responsible, and as to whether peel remained in aisle long enough for defendant, in exercise of due care, to have discovered and removed it). *See also* Millers, Inc. v. Newell,

The harsh consequences of this judicial reluctance are revealed by *J. C. Penney Co. v. Sumrall.*[199] The plaintiff, injured when she slipped and fell in the entrance of the defendant's department store, sued on the ground of the defendant's alleged negligence and recovered $30,000. Plaintiff's witness, a clerk, testified that another customer had vomited in the entrance. The clerk immediately called the janitor, who arrived in time only to help the plaintiff to her feet. The clerk further testified that she previously had been orally instructed to cover any liquid substance on the store's floor until it could be removed.[200] The janitor, who testified that approximately five minutes were required for him to gather his equipment and reach the entrance, was subsequently timed going through the same motions in ninety seconds.[201]

The Mississippi Supreme Court, however, reversed the jury verdict, upholding the general rule that some evidence of negligence must be provided the jury before the defendant may be found negligent.[202] The court noted that the defendant, through its employees, had acted within a reasonable time to remove the substance and therefore nothing remained for jury determination.[203] The dissenters, however, noted that the evidence as to the time available for the clerk to call the janitor and as to the propriety of the clerk's action was contradictory. Consequently, these questions were properly for the jury.[204]

6. Malpractice

There have been significant increases in the number of malpractice claims filed against lawyers in almost every jurisdiction in the United States.[205] In a legal malpractice action, *i.e.* an action against an attorney for negligent violation of duty, the client must prove: (1) the existence of the attorney-client relationship; (2) the acts constituting the alleged negligence; (3) that such negligence was the proximate cause of the injury; and (4) the fact and extent of the alleged injury.[206] Although

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341 So. 2d 101 (Miss. 1976).

Where assumption of risk overlaps and coincides with contributory negligence, the rules of the contributory negligence defense (not a bar to recovery under Mississippi's comparative negligence statute) must apply. If, however, the defendant can prove that the plaintiff's negligence was the sole proximate cause of the injury, such causation may be raised as a defense. Braswell v. Economy Supply Co., 281 So. 2d 669, 677 (Miss. 1973).

[199] 318 So. 2d 829 (Miss. 1975).

[200] *Id.* at 831.

[201] *Id.* at 833-34 (Inzer, J., dissenting).

[202] *Id.* at 832.

[203] *Id.*

[204] *Id.* at 834 (Inzer, J., dissenting).

[205] *See generally* Bresnahan & Kane, *Professional Ethics and Competence in Trial Practice*, 62 A.B.A.J. 989 (1976).

[206] *See* Nause v. Goldman, 321 So. 2d 304, 305 (Miss. 1975).

lawyers may be held liable for negligent failure to use the requisite care or skill, they are not insurers or guarantors of the correctness of their work for the results to be attained.[207] Accordingly, the mere fact that a case was lost does not constitute evidence of negligence. For this reason, the authors have been unable to find any case wherein the doctrine of res ipsa loquitur was held applicable to the alleged negligence of an attorney.[208]

The doctrine has, however, been applied in numerous medical malpractice cases.[209] While such cases often fail due to the lack of proof of

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[207] Wade, *The Attorney's Liability For Negligence*, 12 VAND. L. REV. 755, 760 (1959); *see* Thompson v. Irving's Hatcheries, Inc., 186 So. 2d 756 (Miss. 1966). *Compare* Smith v. St. Paul Fire & Marine Ins. Co., 366 F. Supp. 1283 (M.D. La. 1973), *aff'd*, 500 F.2d 1131 (5th Cir. 1974) (mere fact that attorney formulates opinion upon which he in good faith acts and which is not subsequently affirmed by the courts does not require or necessarily support conclusion that he is guilty of malpractice) *with* Frist v. Leatherwood, Walker, Todd & Mann, 433 F.2d 11 (4th Cir. 1970) (where attorneys did everything necessary to perfect appeal they were not negligent merely because time for appeal had expired without record being printed).

[208] Donato v. Dutton, Kappes & Overman, 288 N.E.2d 795 (Ind. App. 1972) provides a good illustration. In that case, the trial judge denied a counterclaim based upon an attorney's negligence on the ground that res ipsa loquitur did not apply. However, the Indiana Court of Appeals significantly stated:

> We do not fault [the physician's] argument that the doctrine of res ipsa loquitur is as applicable in a case involving an attorney as it is in cases dealing with physicians and surgeons.

Id. at 797. The trial court's judgment was nevertheless affirmed because the necessary element of control was absent. *Id.*

At least one court has specifically held that the doctrine is in no event applicable to an attorney's negligence. Olsen v. North, 276 Ill. App. 457, 473-77 (1934). That court did state, however, that the rules of law governing liability for the negligence of physicians and surgeons toward their patients also govern attorneys' liability for negligence toward their clients. *Id.* at 475.

[209] In the following medical situations, there was sufficient evidence to raise an inference of negligence:

(1) objects left in the patient's body at the time of surgery;
(2) injury to a healthy part of the body in the treatment area, or to a part remote from the treatment area, whether healthy or not;
(3) removal of the wrong part of the body when another part was intended;
(4) teeth dropped down the windpipe (trachea);
(5) burns from (a) hot water bottle, (b) diathermy machines, (c) heat lamps, (d) x-rays, particularly when used for diagnostic purposes, (e) steam vaporizers, (f) chemicals, (g) bedside lamps;
(6) infection resulting from unsterilized instruments;
(7) failure to take x-rays to diagnose possible fractures;
(8) fractures set so badly that the deficiency of workmanship is apparent to anybody;
(9) disability directly resulting from the injection of drugs into the body;
(10) explosion of anesthetic gases.

D. LOUISELL & H. WILLIAMS, *supra* note 128, § 14.06, at 439-41; *see, e.g.*, Prewitt v. Philpot,

proximate cause,[210] some courts have permitted plaintiffs to submit their cases to the jury without expert testimony if the defendant's conduct was so gross and patently negligent as to be within the comprehension of laymen. In this respect, a court's substitution of such "common knowledge" for expert testimony may become categorized as res ipsa loquitur.[211]

Conversely, if the required medical standard of care, the practice or procedure employed and the results in a particular case are all known by virtue of the means employed at trial, then res ipsa loquitur has no application.[212] A leading commentator in this field, however, has noted:

> It is perhaps arguable that an ideal system of discovery would guarantee availability of the facts, to the extent known or determinable by an interested party, and would substantially reduce if not obviate the need for the doctrine of res ipsa loquitur. But, in practice, even the liberal discovery provisions of the Federal Rules of Civil Procedure are gauged

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142 Miss. 704, 709, 107 So. 880, 881 (1926); Maxie v. Laurel Gen. Hosp., 130 Miss. 246, 250-51, 93 So. 817, 817 (1922); Saucier v. Ross, 112 Miss. 306, 314, 73 So. 49, 50 (1916).

The leading California malpractice case, Ybarra v. Spangard, 25 Cal. 2d 486, 154 P.2d 687 (1944), applied the doctrine against several doctors and nurses in an action by a patient apparently injured during the course of an appendectomy. The California Supreme Court reasoned that, in all probability, at least one of the defendants could have explained the occurrence.

> Without the aid of the doctrine a patient who received permanent injuries of a serious character, obviously the result of someone's negligence, would be entirely unable to recover unless the doctors and nurses in attendance voluntarily chose to disclose the identity of the negligent person and the facts establishing liability . . . . If this were the state of the law of negligence, the courts, to avoid gross injustice, would be forced to invoke the principles of absolute liability, irrespective of negligence, in actions by persons suffering injuries during the course of treatment under anesthesia.

154 P.2d at 689. *Ybarra* was cited with approval in Palmer v. Clarksdale Hosp., 206 Miss. 680, 694, 40 So. 2d 582, 584 (1949). Some authorities feel, however, that the doctrine should be applied to multiple defendants only if it is clear that they are jointly liable. *See generally* Cowan & Malinak, *supra* note 110.

[210] D. Louisell & H. Williams, *supra* note 128, § 11.20, at 324; *see* Magnolia Hosp. v. Moore, 320 So. 2d 793 (Miss. 1975).

[211] McCoid, *The Care Required of Medical Practitioners*, in Professional Negligence 13 (1960). One writer has observed that by crediting laymen with more than the traditional quantum of common knowledge and thus expanding res ipsa, the courts may tend to equate poor treatment results with medical malpractice. But man's "common knowledge" should not be so "unreasonably broadened to include merely unsatisfactory results." Rothstein, *Malpractice: Trends and Techniques*, in Torts Trends 77 (Miss. Law Inst. 1971). With respect to the distinction between the doctrines of common knowledge and res ipsa loquitur, see Sanzari v. Rosenfeld, 34 N.J. 128, 167 A.2d 625 (1961). *See also* Dazet v. Bass, 254 So. 2d 183, 187 (Miss. 1971) (negligence must be shown in case involving highly complex operation).

[212] Ross v. Hodges, 234 So. 2d 905 (Miss. 1970) (doctrine not applicable where facts had been brought before jury through affirmative proof).

> primarily to compel disclosure after commencement of action; the victim of injury while unconscious during an operation may not, in the absence of res ipsa loquitur, have enough information to frame a complaint. Further, discovery can be expensive, and should not be made to do the work that can economically and logically be accomplished by proper placement of the original or basic burden of disclosing facts.[213]

B. Parties

Theoretically, the particular relationship between the parties should be irrelevant in determining the applicability of res ipsa loquitur. However, the type of relationship existing between the plaintiff and the defendant may have a significant effect upon a particular court's willingness to apply the doctrine.

1. Business Invitees

It is well settled that "a business proprietor is not an insurer of business invitees entering his place of business."[214] Indeed, the business invitee is owed no more than the exercise of reasonable care to provide a reasonably safe place for he or she to transact business.[215] In light of these principles, the Mississippi courts have consistently refused to apply res ipsa in one particular class of litigation—the "slip and fall" cases.[216] Thus, mere proof of the presence of some foreign substance on the floor of a business establishment is generally insufficient to support the claim of an invitee who slipped on the substance.[217] However, if a floor is made slippery by water escaping from an appurtenance under the owner's control, the doctrine may apply.[218] Despite its strict ap-

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[213] D. LOUISELL & H. WILLIAMS, *supra* note 128, §15.01, at 464-65.

[214] *E.g.*, Daniels v. Morgan & Lindsey, Inc., 198 So. 2d 579, 584 (Miss. 1967); *accord,* J. C. Penney Co. v. Sumrall, 318 So. 2d 829, 832 (Miss. 1975); King v. Dudley, 286 So. 2d 814, 816 (Miss. 1973). An "invitee" has been defined as

> one who goes onto the premises of another at the express or implied invitation of the owner or occupant on the business of the owner or occupant or for their mutual advantage.

Mayer v. Cities Serv. Oil Co., 258 F. Supp. 230, 232 (N.D. Miss. 1966), *citing* Wright v. Caffey, 239 Miss. 470, 123 So. 2d 841 (1960); Nowell v. Harris, 219 Miss. 363, 68 So. 2d 464 (1953).

[215] Braswell v. Economy Supply Co., 281 So. 2d 669, 677 (Miss. 1973); Gulfport Winn-Dixie, Inc. v. Taylor, 246 Miss. 332, 341, 149 So. 2d 485, 488 (1963); Sears, Roebuck & Co. v. Burke, 208 Miss. 306, 321, 44 So. 2d 448, 451 (1950).

[216] *E.g.*, Daniels v. Morgan & Lindsey, Inc., 198 So. 2d 579, 584 (Miss. 1967); Sears, Roebuck & Co. v. Tisdale, 185 So. 2d 916, 917 (Miss. 1966).

[217] *E.g.*, Daniels v. Morgan & Lindsey, Inc., 198 So. 2d 579, 585 (Miss. 1967) (wax); F. W. Woolworth Co. v. Stokes, 191 So. 2d 411, 417 (Miss. 1966) (water, mud or snow); Sears, Roebuck & Co. v. Tisdale, 185 So. 2d 916, 917 (Miss. 1966) (litter and debris). *See also* Dees v. Campbell, 183 So. 2d 624, 626 (Miss. 1966) (oil on parking lot).

[218] 2 S. SPEISER, *supra* note 130, § 27:6, at 421-22.

proach in the slip-and-fall context, the Mississippi court has not completely abrogated the res ipsa context in a business premises situation.[219]

2. Innkeepers

While the Mississippi courts have not considered the application of res ipsa in a suit against a motel or hotel owner, the Fifth Circuit has decided such a case, applying Mississippi law. In *Crawford v. Worth,*[220] the plaintiff had brought suit to recover for burns he received while showering in one of the defendant's motel rooms.[221] At trial, the plaintiff, relying upon res ipsa, requested an instruction that would have required the jury to find the defendant liable based upon a plumbing deficiency which caused the release of hot water.[222] In affirming the trial court's refusal to so instruct the jury, the court of appeals stated:

> Since plaintiff was not disabled in any demonstrated way from testing the specific physical capabilities of the defendant's water system and since the issue was put to the jury to resolve a specific fact conflict as to whether excessively heated water caused plaintiff's injuries, we hold the lower court was correct in rejecting the res ipsa instruction.[223]

Although it may appear that the instrumentality which caused the accident in *Crawford* was within the defendant's exclusive control, the defendant nevertheless succeeded in casting a cloud of uncertainty over the element of causation. To the extent that res ipsa never supplies proximate cause, the holding is consistent with the rationale underlying the doctrine.

3. Lessor-Lessee

In many cases, application of the doctrine may be affected by the fact that the premises upon which the injury was sustained are subject to a lease.[224] Since res ipsa's application often depends upon the defendant's degree of control over the injuring instrumentality, the ex-

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[219] *See* Fisher v. Daniels, 252 Miss. 662, 173 So. 2d 908 (1965); Ballenger v. Vicksburg Hardwood Co., 238 Miss. 654, 119 So. 2d 778 (1960).

[220] 447 F.2d 738 (5th Cir. 1971).

[221] *Id.* at 739-40.

[222] *Id.* at 741.

[223] *Id.* at 742. *But cf.* Hull v. Holiday Inns of America, Inc., 478 F.2d 224 (6th Cir. 1973). In *Hull,* an action was brought against a motel owner for injuries to a guest allegedly caused by excessively hot water in the bathtub. *Id.* at 224. The trial court granted the defendant motel owner's motion for a directed verdict. The Sixth Circuit reversed, holding that the jury was entitled to draw inferences from the physical facts as well as the oral evidence and that the questions of whether the water was excessively hot and whether the guest was contributorily negligent were for the jury. *Id.* at 226.

[224] *See* 2 S. SPEISER, *supra* note 130, § 18:23, at 91.

istence of a lease may indicate control of the premises by the lessee, the lessor or both. Moreover, a lessor attempting to hold his lessee liable for losses allegedly occasioned by the lessee's negligence may find that res ipsa will apply only if he can show that the alleged negligence was the proximate cause of the loss.[225]

Also worthy of consideration is the question of whether a lessor's contractual right to inspect the leased premises would vest in the lessor sufficient control and management to justify application of the doctrine.[226] If so, such an inspection could place the landlord in a vulnerable position. If a third party is injured because of a defective condition in the premises, the landlord, by virtue of his inspection, could be deemed to have assumed sufficient management and control of the premises to justify application of the doctrine. Conversely, if the lessor inspects the premises pursuant to the lessee's invitation, the lessor may be held to be a business invitee.[227] This status could impose liability upon the lessee for damages arising from the lessor's injuries proximately caused by the lessee's failure to keep the premises in a reasonably safe condition.[228]

4. Vendor-Vendee and Manufacturer-Consumer

Since 1916, when "there came the phenomenon of the improvident Scot who squandered his gold upon a Buick, and so left his name forever imprinted on the law of products liability,"[229] the concept of privity has been battered.[230] Initially, the doctrine of res ipsa loquitur was restricted to cases in which there was a breach of duty arising from privity of contract between the plaintiff and the defendant. The current view, however, both legislative and judicial, is that the absence of privity of contract does not preclude the doctrine's application.[231] Thus, the inference of negligence may properly arise not from the nature of the relation between the parties, but from the circumstances and nature of

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[225] Bush v. Laux, 232 Miss. 63, 68-69, 97 So. 2d 923, 924 (1957).

[226] *Cf.* Jones v. Millsaps, 71 Miss. 10, 14 So. 440 (1893). In *Jones,* the court held that where a lessor, although not contractually bound to do so, undertakes certain repairs during the lease term, he may be held liable for want of due care in the execution of the work. Such liability is based upon negligence rather than any implied covenant to repair or implied consideration. *Id.* at 18-19, 14 So. at 441.

[227] *See generally* section III. *B.* 1. *supra.*

[228] *Cf.* Aetena Cas. & Sur. Co., 484 F.2d 289 (5th Cir. 1973) (liability of insurer to insured not assumed from permissive inspection clause in policy).

[229] Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer),* 69 YALE L.J. 1099, 1100 (1960).

[230] *Id.* at 1099-1100.

[231] *See* Act of Apr. 27, 1976, ch. 385, § 5, 1976 Miss. Laws 977; Maraist & Barksdale, *supra* note 2, at 145-46.

the occurrence. The relationship of the parties should be material only to the extent that it defines the measure of duty legally imposed upon the defendant.[232]

Prior to *State Stove Manufacturing Co. v. Hodges*,[233] the Mississippi Supreme Court had not expressly adopted the concept that a person not in privity with a manufacturer may recover for injuries caused by the manufacturer's negligence.[234] In fact, only four years earlier in *Harrist v. Spencer-Harris Tool Co.*,[235] the court expressly refused to decide whether to abandon the privity requirement.[236] Despite Chief Justice Ethridge's broad declaration in *State Stove* that "privity of contract is not necessary in a suit by a consumer against a manufacturer,"[237] the question still remained as to whether privity would be required in a purchaser's suit against a vendor other than the manufacturer of an allegedly defective product.

The question was apparently resolved in *Cadillac Corp. v. Moore*.[238] In *Moore*, a plaintiff brought suit to recover for personal injuries and property damage caused by the explosion of a new heater in a mobile home purchased from the defendant.[239] Although the defendant installed the heater, it had purchased the product directly from the manufacturer. The defendant, denying the presence of any defect in its mobile home, contended that the responsibility arising from the defective heater was that of the manufacturer, which was not a party to the suit.[240] Although the court precluded plaintiff's reliance upon strict liability in tort because of his failure to obtain a jury instruction addressing that principle, it indicated that liability could nevertheless be predicated upon a res ipsa theory.[241] Significantly, the court then found a vendor-

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[232] *See generally* 1 S. SPEISER, *supra* note 45, § 1:6, at 16-17.

[233] 189 So. 2d 113 (Miss. 1966), *cert. denied*, 386 U.S. 912 (1967), *noted in* 38 MISS. L.J. 341 (1967).

[234] 189 So. 2d at 117. Numerous exceptions, however, had been grafted on the privity requirement. Cox v. Laws, 244 Miss. 696, 701-02, 145 So. 2d 703, 706 (1962) (no privity required when allegedly negligent conduct violated statute or ordinance). The proposition presented in *State Stove*, however, is now well entrenched in Mississippi jurisprudence. *See* Denman v. Armour Pharmaceutical Co., 322 F. Supp. 1370 (N.D. Miss. 1970).

[235] 244 Miss. 84, 140 So. 2d 558 (1962).

[236] Assuming, arguendo, (but not deciding this point at this time), this Court may ultimately adopt the so-called modern concept that a person who has no contractual relations with a manufacturer may recover from injuries caused by negligence of the manufacturer, nevertheless [the results in the instant case remain unaltered].

Id. at 94, 140 So. 2d at 561.

[237] 189 So. 2d at 117. *But see* Cox v. Laws, 244 Miss. 696, 145 So. 2d 703 (1962).

[238] 320 So. 2d 361 (Miss. 1975).

[239] *Id.* at 362.

[240] *Id.* at 363-64.

[241] The court stated that "although it is true . . . that the plaintiff did not directly

purchaser relationship significant enough to impose upon the defendant a duty of reasonable inspection and repair of its inventory.[242] This duty, the court concluded, could not be terminated by the bare assertion that the heater was manufactured by another.[243]

The requirement of privity of contract in the negligence context was officially jettisoned by the state legislature on April 27, 1976:

> In all causes of action for personal injury or property damage or economic loss brought on account of negligence, strict liability or breach of warranty, including actions brought under the provisions of the Uniform Commercial Code, privity shall not be a requirement to maintain said action.[244]

Thus, during the last fifteen years, both the legislative and judicial branches of the state government have rejected the privity requirement in negligence cases. The consequences are clear: Despite the growing popularity of strict liability in tort, the way is now cleared to utilize res ipsa as a viable alternative in negligence suits against the manufacturers or vendors of injury-producing products. Both counsel and the consumer should revel in the death of what has been a cumbersome albatross.

IV. Use of Res Ipsa in Products Liability Cases

A. Negligence

1. Negligent Design

One negligence theory frequently relied upon by plaintiffs in products liability cases is that of negligent design. In such cases, an obvious necessity arises to test the reasonableness of a product's design by objective standards. Frequently named components of such a test include: (1) the extent to which the plaintiff has used the product and the period of time the product has been used without incident;[245] (2) similarity between the defendant's design and the designs of other members of the industry at the time of manufacture;[246] and (3) the open-and-obvious

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prove the precise cause of the explosion, it is likewise true that negligence may be proved by circumstantial evidence . . . ." *Id.* at 366.

[242] *Id.* at 364-65.

[243] *Id.* at 365.

[244] Act of Apr. 27, 1976, ch. 385, § 5, 1976 Miss. Laws 977. Perhaps this enactment will serve to abrogate the harsh results seen two years earlier in Oliver v. City Builders, Inc., 303 So. 2d 446 (Miss. 1974), *noted in* 46 Miss. L.J. 510 (1975).

[245] *See* Tomicich v. Western-Knapp Eng'r Co., 423 F.2d 410, 413 (9th Cir. 1970); Marker v. Universal Oil Prods. Co., 250 F.2d 603, 606 (10th Cir. 1957).

[246] There is uniform agreement that the reasonableness of the challenged conduct must be determined in light of the circumstances existing at the time of manufacture. *E.g.*, Vroman v. Sears, Roebuck & Co., 387 F.2d 732, 737-38 (6th Cir. 1968); Pontifex v. Sears, Roebuck & Co., 226 F.2d 909, 910 (4th Cir. 1955).

nature of the alleged defect.[247] Of the three, the most frequently litigated in state[248] and federal courts[249] is the "open-and-obvious" rule.

> As a general rule in negligent design cases,
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> where the alleged danger is open and obvious and the manufacturer has done everything necessary to insure that the machine will function properly for its designed purpose any duty owed to a future user has been fulfilled.[250]

In *Ward v. Hobart Manufacturing Co.*,[251] however, the court stated that since in certain circumstances "even an open and obvious danger might be an unreasonable one,"[252] it would "treat the open and obvious nature of a danger as only one factor in determining reasonableness of design."[253] Such a flexible application of the rule is indeed desirable since a more rigid approach could arguably circumvent the policies underlying Mississippi's comparative negligence statute.[254]

In *State Stove Manufacturing Co. v. Hodges*,[255] the court, in recognizing the doctrine of strict liability in tort, announced that the newly adopted rule was not exclusive. "It does not preclude liability based upon the alternative ground of negligence of the manufacturer or seller, where such negligence can be proved."[256] Thus, it is entirely possible for the plaintiff to proceed upon alternative theories, subject only to the limitations of proof.[257] When the plaintiff elects to proceed upon a strict liability theory, however, the defendant is not entitled to raise questions of negligence. For example, in *Hamilton Fixture Co. v. Anderson*,[258] the plaintiffs sought to recover under strict liability from a company which installed a defectively designed humidifier in their home.[259] Affirming the trial judge's refusal to instruct the jury for the defendant, the court noted that even if the negligence of the defendant had been pertinent,

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[247] *E.g.*, Zahora v. Harnischfeger Corp., 404 F.2d 172, 176-77 (7th Cir. 1968).

[248] *See, e.g.*, Harrist v. Spencer-Harris Tool Co., 244 Miss. 84, 94-95, 140 So. 2d 558, 561 (1962). *But see* Pike v. Frank G. Hough Co., 467 P.2d 229 (Cal. 1970).

[249] *See, e.g.*, Kerber v. American Mach. & Foundry Co., 411 F.2d 419, 421 (8th Cir. 1969); Messina v. Clark Equip. Co., 263 F.2d 291, 293 (2d Cir.), *cert. denied*, 259 U.S. 1013 (1959).

[250] Ward v. Hobart Mfg. Co., 450 F.2d 1176, 1188 (5th Cir. 1971) (footnote omitted); *see* Harrist v. Spencer-Harris Tool Co., 244 Miss. 84, 94-95, 140 So. 2d 558, 561 (1962).

[251] 450 F.2d 1176 (5th Cir. 1971).

[252] *Id.* at 1182 n.17.

[253] *Id.*

[254] *See* MISS. CODE ANN. § 11-7-15 (1972).

[255] 189 So. 2d 113 (Miss. 1966), *cert. denied*, 386 U.S. 912 (1967).

[256] 189 So. 2d at 118 (citation omitted).

[257] *See* Cadillac Corp v. Moore, 320 So. 2d 361 (Miss. 1975).

[258] 285 So. 2d 744 (Miss. 1973).

[259] *Id.* at 746.

the defect in design would not necessarily import such negligence.[260] Despite the availability of alternative theories of recovery in the defective design context, Professor Wade has found little difference between an action based upon negligence and one based upon strict liability in tort.[261]

> This is true, at least, for the manufacturer, who normally either knows of the danger which the design creates or should know (i.e., is negligent in not knowing of it); it is less true of a supplier, who may take the product from the manufacturer without inspecting it in detail. Under design is included [in] the failure to provide proper safety devices. Design may include the parts or elements which do or do not go into the makeup of a product, if it is intended to be in that condition.[262]

Finally, it should be noted that the seller of a used product also may be held liable for injuries attributable to design defects in his product.[263] Such liability, however, can be predicated only upon warranty or negligence theories.[264]

2. Second Accident

In the usual case, it is the defective design of the product itself which initially causes the plaintiff's injuries. However, additional and more difficult questions arise when the defect simply combines with the force put in motion by the initial accident. If the defect thereby augments the cause of a personal injury or enhances its seriousness, the product manufacturer may interpose the "second accident" defense in an attempt to escape liability. The defendant in *Walton v. Chrysler Motor Corp.*[265] advanced just such a defense.

In *Walton,* the plaintiff's automobile was struck from the rear while stopped at an intersection, causing the plaintiff to be thrown backward against the seat. The seat collapsed and the plaintiff suffered serious injuries as a result.[266] At trial, the plaintiff attributed his injuries to the negligence of the other driver and to the manufacturer of his automobile. Specifically, he alleged that the defendant manufacturer had been

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[260] *Id.* at 747.

[261] Wade, *On the Nature of Strict Tort Liability for Products,* 44 MISS. L.J. 825, 841 (1973). *But see* Ward v. Hobart Mfg. Co., 450 F.2d 1176 (5th Cir. 1975) (essential differences in "strict liability" and "negligent design" cases).

[262] Wade, *supra* note 261, at 841 (footnote omitted).

[263] Pridgett v. Jackson Iron & Metal Co., 253 Sc. 2d 837 (Miss. 1971).

[264] *See id.* at 840, *citing* Witt Ice & Gas Co. v. Bedway, 72 Ariz. 152, 231 P.2d 952 (1951); Mulder v. Casho, 61 Cal. 2d 633, 394 P.2d 545, 39 Cal. Rptr. 705 (1964); Brown v. Hall, 221 So. 2d 454 (Fla. 1969); Foy v. Ed Taussig, Inc., 220 So. 2d 229 (La. App. 1969).

[265] 229 So. 2d 568 (Miss. 1969).

[266] *Id.* at 569-70.

negligent in " 'improperly designing and in wrongfully, negligently, and improperly manufacturing an automobile seat which was not reasonably safe for its intended use.' "[267]

After noting that the alleged defect in the plaintiff's automobile did not cause the initial accident, the court recognized that such a defect could have added, or in fact did add to the seriousness of the plaintiff's injury.[268] The court then addressed the plaintiff's argument:

> [Plaintiff] in the instant case contends that it is the duty of the manufacturer to foresee accidents, and to design its vehicle so as to reduce the possibility of injury to the users of their products. Stating the argument differently: the manufactured product must be reasonably fit for its intended use, free of hidden defects that could render the product unsafe for highway use. It is then argued that it was well known to the manufacturer that automobiles will be "bumped" or "rammed from the rear" and that many persons are being killed, hurt and injured by accidents similar to the accident here involved, and that the manufacturer could reasonably foresee that the plaintiff would be injured as a result of the dangerous and faulty design of its product. It is therefore liable to the plaintiff, although the defect in the design of the automobile did not cause the accident, but added to the seriousness or gravity of the injury.
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> . . .
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> The strict liability rule for products liability cases adopted by this Court eliminates the necessity to show negligence in the manufacture of the product where it is shown that the product left the hands of the manufacturer in a defective condition, but this rule does not eliminate the requirement that, even where there is a defect in the product, that there must be some duty owed to the plaintiff with regard to the defect, growing out of intended normal use for which the product was manufactured.[269]

The court accordingly held that the automobile manufacturer was not liable to the plaintiff for injuries arising from defects in the automobile if they did not cause or contribute to the cause of the accident, "although such accident may have been foreseeable as a misuse of the

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[267] *Id.* at 571.

[268] In the instant case, it is clear that the alleged defect in the automobile did not cause the accident. It is equally clear, however, that the weakness of the bumper and screw [in the seat] did, or could have, added to the seriousness of the plaintiff's injury. The driver of the automobile that crashed into the rear of the automobile operated by the plaintiff caused the accident. Nevertheless, *plaintiff believes and charges that he would not have been seriously injured if the back of the automobile seat in which he was riding had not broken so as to let the back flop to a prone position.*

Id. at 570 (emphasis added).

[269] *Id.* at 572, 573.

manufactured product."[270] The duty concept incorporated in the strict liability theory by the *Walton* court has been viewed as tantamount to a conclusion of negligence. Indeed, the court's decision has been interpreted as possibly eradicating recovery under the theory of strict liability in tort from Mississippi products liability law.[271]

If such second accident cases were predicated upon a negligent design theory, with proof of negligent design being supplied by res ipsa loquitur, would the court be as reluctant to find liability? Professor Wade has suggested that the scope of risk under a negligence-based products liability case for injury resulting from a second collision may be broader than the scope of risk in a strict liability case.[272] His suggestion finds support in the principle that where the negligence of two persons combine to produce an injury, the fact that one's negligence occurred prior to the other's is not controlling.[273] However, in using such an alternative negligence theory in a second accident case, the negligence, if any, of the third party driver may be considered an intervening cause and thereby preclude liability.[274]

The leading case holding a manufacturer liable in a second accident situation is *Larsen v. General Motors Corp.*[275] In *Larsen,* an action was brought against the manufacturer of a Corvair automobile for negligent

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[270] *Id.* at 572; Ford Motor Co. v. Matthews, 291 So. 2d 169, 177 (Miss. 1974), *noted in* 45 MISS. L.J. 1287 (1974).

Other cases utilizing similar reasoning are Turner v. Big Four Automotive Equip. Corp., 511 F.2d 133 (5th Cir. 1975); General Motors Corp. v. Howard, 244 So. 2d 726 (Miss. 1971); and Ford Motor Co. v. Simpson, 233 So. 2d 797 (Miss. 1970). The "unspoken rationale" for the result in this line of second accident cases may well be the court's reluctance to extend the liability of manufacturers in Mississippi, Ward v. Hobart Mfg. Co., 450 F.2d 1176, 1189 (5th Cir. 1971), together with the court's realization that in a primarily agricultural state,

> limited products liability might result in a subsidization of out of state industries by the state and its citizens, while broad recovery for products liability might make some desirable products unavailable within the state and may hamper industrial growth within the state.

Maraist & Barksdale, *supra* note 2, at 164 n.152.

[271] Maraist & Barksdale, *supra* note 2, at 150.

[272] Wade, *The New Liability for Products,* in TORT TRENDS 14 (Miss. Law Inst. 1971).

> For an action based upon negligence it would seem that a manufacturer should be held to the duty of seeking to make his product duly safe for uses which might be reasonably foreseen. Of course, it may be argued that for strict liability, which is imposed on an objective basis without having to find negligent conduct, a narrower scope as to the nature of the use may be appropriate.

Wade, *supra* note 217, at 847.

[273] State Stove Mfg. Co. v. Hodges, 189 So. 2d 113, 123 (Miss. 1966), *cert. denied,* 386 U.S. 912 (1967).

[274] Wade, *supra* note 226.

[275] 391 F.2d 495 (8th Cir. 1968).

design of the steering assembly. The Eighth Circuit rejected the second accident defense, noting that there was no rational basis for limiting the plaintiff's recovery

> where the defect in design or manufacture was the causative factor of the accident, as the accident and the resulting injury, usually caused by the so-called "second collision" of the passenger with the interior part of the automobile, are all foreseeable.[276]

The court indicated that general negligence principles should apply where enhanced injuries result from a manufacturer's failure to use reasonable care to avoid subjecting the product's user to an unreasonable risk of injury. The court opined that the function of an automobile should not be merely a means of transportation but, in addition, should be as safe a means of transportation as is reasonably possible under the present state of the art.[277] With respect to foreseeability, the court remarked that "collisions with or without fault of the user are clearly foreseeable by the manufacturer and are 'statistically inevitable.'"[278] The court indicated that the manufacturer, the public and the court should squarely face the realities of the actual and intended use of such products and that the manufacturer should exercise reasonable care in designing its vehicles, thereby mitigating the effect of accidents. The court also noted that

> [t]he duty of reasonable care in design should be viewed in light of the risk. While all risks cannot be eliminated nor can a crash-proof vehicle be designed under the present state of the art, there are many common-sense factors in design, which are or should be well known to the manufacturer that will minimize or lessen the injurious effects of a collision. The standard of reasonable care is applied in many other negligence situations and should be applied here.[279]

The *Larsen* court held that the duty imposed upon the manufacturer in the design defects field should rest upon general negligence principles, perhaps supplemented as a matter of social policy by the theory of strict liability in tort.[280] The state of the art concept also could be utilized by the injured plaintiff who bases his design defect case upon an alternative negligence theory. Additionally, this approach could help the plaintiff avoid the harsh effects of the second accident doctrine.[281]

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[276] *Id.* at 502.

[277] *Id.* at 503.

[278] *Id.* at 502.

[279] *Id.* at 503.

[280] *Id.* at n.5.

[281] *But see* General Motors Corp. v. Howard, 244 So. 2d 726, 729 (Miss. 1971); Walton v. Chrysler Motor Corp., 229 So. 2d 569, 572 (Miss. 1969).

In this context, recovery in a second accident case could be permitted under the doctrine of res ipsa loquitur if the plaintiff could show that: (1) the second accident would not have ordinarily occurred in the absence of negligent design; (2) the defendant manufacturer was in exclusive control of the instrumentality at the time of the negligent act or omission giving rise to the faulty design; (3) the plaintiff did not materially contribute to the second accident, *i.e.* he did not cause the first accident; and (4) he is not able to show the particular circumstances causing the instrumentality to operate to his injury.

3. Negligent Failure to Inspect or Warn

A manufacturer's duty of reasonable care includes the duty to inspect its product. This duty has been extended by some courts to products which are manufactured by another but are component parts of the defendant's ultimate product.[282] The theories of recovery under which a manufacturer is held liable for failure to inspect or test during and after the manufacturing process are "usually part and parcel of the larger charge of negligent design or negligent construction."[283]

In *Gray v. Hayes-Sammons Chemical Co.*,[284] for example, an action for crop damage allegedly caused by a harmful herbicide contained in a can sealed by its manufacturer, the Fifth Circuit applied Mississippi law to reject the manufacturer's contention that res ipsa did not apply to damage from sealed insecticide cans.[285] The court reasoned that the doctrine was as applicable to this case as it was to injury from beverage bottles. Although it recognized that no Mississippi case had applied the doctrine to crop damage caused by contaminated insecticides, the court nevertheless concluded that the plaintiff should be entitled to invoke the doctrine in such a products liability case.[286] In *Charbonneau v. Wilbur Ellis Co.*,[287] however, the doctrine was held to be inapplicable on similar facts. In that case, the owner of an apple orchard suffered extensive tree and crop damage after applying a formula as the dormant spray on his orchard. The evidence did not show that such damage would not occur in the absence of negligence, and the manufacturer was not shown

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[282] *E.g.*, Rauch v. American Radiator & Standard Sanitary Corp., 252 Iowa 11, 104 N.W.2d 607, 611 (1960).

[283] Hare, *Elements of Proof—Plaintiff's Side of Products Liability Case*, in PRODUCTS LIABILITY 39 (Miss. Law Inst. 1973).

[284] 310 F.2d 291 (5th Cir. 1962).

[285] *Id.* at 298. "The doctrine is [,however,] more likely to be applied in a situation where a product packed in a sealed container contains some foreign substance." Noel, *Manufacturers of Products—The Drift Toward Strict Liability*, 24 TENN. L. REV. 963, 977 (1957).

[286] 310 F.2d at 299 (footnote omitted).

[287] 9 Wash. App. 474, 512 P.2d 1126 (1973).

to have had exclusive control of the damage-causing instrumentality.[288]

The seller of a used product also may be held liable for injuries due to defects in a product on the theory of negligent failure to inspect or warn, and an inference of such negligence may be supplied under the doctrine of res ipsa loquitur. This is true even though the seller may not be liable under the theory of strict liability in tort.[289] This inference could, of course, be overcome by the manufacturer's showing of its thorough inspection of the product.[290]

B. Strict Liability in Tort

1. Absolute Liability Distinguished

Despite the aid of res ipsa loquitur and the availability of proof that the product was actually defective and caused the plaintiff's injury or damage, a plaintiff often finds it quite difficult to prove a manufacturer's negligence. Although the theory of strict liability in tort has been considered by some as a form of absolute liability, it does not make a manufacturer, distributor or retailer an insurer of the consumer's safety. Strict liability in tort is liability without negligence, not liability without fault.

> There must be a defect in the product, it must be established as existing at the time of leaving the defendant's control, and it must be such as to render the product unreasonably dangerous to the consumer. In order to prove that a product was in fact defective, the plaintiff will have to produce evidence of fault, however denominated. Circumstantial evidence, even in the absence of the product itself, is frequently sufficient for the plaintiff to prove the defect. Circumstantial evidence has also been held sufficient to prove that the product caused the injury.[291]

In this respect, res ipsa may be perceived as a method of achieving absolute liability in certain situations. If the act or omission leading to the plaintiff's injury or damage was entirely under the defendant's control, and if the accident left no clues that might have explained the occurrence, use of the doctrine will get the plaintiff to the jury "in the name of negligence" although the defendant will probably have no better explanation than the plaintiff.

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[288] 512 P.2d at 1128.

[289] *Cf.* Pridgett v. Jackson Iron & Metal Co., 253 So. 2d 837 (Miss. 1971). *See generally* Coca Cola Bottling Works, Inc. v. Petty, 190 Miss. 631, 200 So. 128 (1941); Maraist, *supra* note 101, at 139.

[290] Gates v. Greyhound Corp., 197 F. Supp. 341, 345 (S.D. Miss. 1960).

[291] Coccia, *Your Product Is Defendable,* 40 INS. COUNSEL J. 130, 131 (1973).

2. Proof of Causation and Defectiveness

Baker v. Ford Motor Co.[292] was an automobile buyer's action against a manufacturer and dealer based upon the alleged failure of his automobile brakes and the dealer's alleged failure to inspect the automobile. The plaintiff, faced with insufficient proof both of the defectiveness of the master cylinder and that the cylinder's condition contributed to the cause of the accident, set forth this novel contention:

> [W]hen specific causal connection cannot be shown, the doctrine of "inferred negligence" or res ipsa loquitur should be applied where the facts are so constituted that an "inference of causation" naturally springs from the facts shown.[293]

The court did not specifically rule out the application of res ipsa in this case, which was based upon strict liability in tort. Several authorities were cited, however, for the proposition that reliance on the doctrine does not relieve a plaintiff of the requirement of showing both an actual defect and proximate cause.[294]

It remains uncertain whether the court in *Baker* actually meant that the doctrine of res ipsa loquitur is available to the plaintiff in a products liability case based upon strict liability in tort. Since res ipsa deals only with permissible inferences from unexplained events, an accident arguably need not be explicable only in terms of negligence in order for the doctrine to be invoked. Further clarification of this point would be helpful to Mississippi attorneys since the court in *Baker* may have indicated a willingness to extend the doctrine's application beyond the ambits of general negligence principles.

3. Use of Res Ipsa Loquitur as an Alternative Negligence Theory

In light of the court's language in *Baker,* it is possible that a res ipsa-type inference, without the requirement that the injury be one which ordinarily would not occur in the absence of negligence, can be utilized in products liability cases based upon strict liability in tort. Although proof of a manufacturer's negligence is not necessary under this theory,[295] it is clear that, in a proper case, the plaintiff may sue on the alternative grounds of strict liability and negligence.[296] To be sure, the Mississippi Supreme Court has stated that reliance on strict liability

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[292] 317 So. 2d 51 (Miss. 1975).

[293] *Id.* at 53-54.

[294] *Id.*

[295] *See, e.g.*, Bohannon v. Chrysler Motor Corp., 366 F. Supp. 802, 813 (S.D. Miss. 1973).

[296] *See* Creel v. General Motors Corp., 233 So. 2d 105, 108 (Miss. 1970).

in tort does not preclude imposition of liability on the alternative ground of negligence, provided either direct or circumstantial evidence of such negligence is available.[297]

Depending upon the facts of a given case, res ipsa also may be an attractive alternative to strict liability in tort.[298] Mississippi products liability plaintiffs since *State Stove* have relied upon strict liability in tort almost to the exclusion of negligence because, among other reasons, proof of the manufacturer's negligence is often difficult. Even with the aid of res ipsa, the plaintiff's proof must support a logical inference of negligence strong enough to take the case to the jury. Such proof is often unavailable and its necessity is often eliminated by strict liability in tort.[299]

The crux of the confusion in the Mississippi Supreme Court's application of the strict liability in tort theory is the court's "innocent commingling" of negligence principles with strict liability in tort.[300] The distinction between and the problems of proving liability under alternative grounds of negligence and strict liability in tort have been obfuscated. Moreover, the function, effect and limitations of each ground have not been consistently recognized. It has been suggested that strict liability in tort will soon render general negligence principles superfluous in the products liability field.[301] Some commentators have argued, however, that there is apparently little difference between a manufacturer's liability based upon a res ipsa theory and his liability based upon strict liability in tort.[302] Despite the tendency to categorize strict liability in tort and negligence as "close cousins,"[303] each theory nevertheless is perceived by the Mississippi Supreme Court as having its own sphere of influence.[304] According to Maraist and Barksdale, the practical distinction between these two theories is that

> [u]nder [Restatement (Second) of Torts, Section] 402A there must be a showing that the product left the seller's hands in an unreasonably dangerous condition and the plaintiff must have been injured as a result of contemplated use of the product. This differs from the requisite showing of negligence only in that in negligence the plaintiff must

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[297] Ford Motor Co. v. Cockrell, 211 So. 2d 833, 836 (Miss. 1968).

[298] *See generally* Necaise v. Chrysler Corp., 335 F.2d 562, 568-70 (5th Cir. 1964).

[299] Wade, *supra* note 261, at 826.

[300] 45 MISS. L.J. 1287, 1293 (1974).

[301] *But see* Jiminez v. Sears, Roebuck & Co., 482 P.2d 681, 93 Cal. Rptr. 969 (1971).

[302] *See, e.g.*, Whitford, *Strict Products Liability and the Automobile Industry: Much Ado About Nothing*, 83 U. WIS. L. REV. 83, 127, 160 (1968). *See generally* Baker v. Ford Motor Co., 317 So. 2d 51 (Miss. 1975).

[303] Pedrick, *supra* note 171, at 21.

[304] *See, e.g.*, Morgan v. Mississippi Power Co., 298 So. 2d 698 (Miss. 1974); Hamilton Fixture Co. v. Anderson, 285 So. 2d 744 (Miss. 1974).

> also prove that there was a breach of duty and that the conduct was unreasonable under the circumstances. *Res ipsa* furnishes the breach, . . . and thus the only distinction is that in negligence the judge or jury must determine whether the defendant acted as a reasonable man in placing the product upon the market, and in 402A liability they must determine whether the product which was placed on the market was unreasonably dangerous. Drawing such a distinction is difficult for a judge and impossible for a jury . . . .[305]

C. Warranty

The doctrine of res ipsa loquitur has been used by some courts in products liability cases where there was some hesitancy to recognize an implied warranty running from the manufacturer to the injured party.[306] Indeed, the Mississippi Supreme Court has held that evidence in a products liability case based upon implied warranty may be sufficient to send a case to the jury under the doctrine of res ipsa loquitur.[307] However, in an action for breach of implied warranty that a bottled drink was pure and wholesome, where it was shown that the bottle contained glass particles when it was sealed and distributed, the court held that the manufacturer's negligence was not to be considered in such an action.[308] Perhaps in an effort to clarify this position, the court later observed in *Ford Motor Co. v. Cockrell*:[309]

> [R]ules defining and governing warranties that were developed to meet the needs of commercial transactions cannot properly be invoked to govern the manufacturer's liability to those injured by their defective products unless those rules also serve the purposes for which such liability is imposed.[310]

It is thus clear that strict liability in tort does not depend upon either warranty or negligence for its existence. On the other hand, the existence of liability on the basis of warranty or negligence does not necessarily permit the imposition of liability on the basis of strict liability in tort.[311]

The limited abrogation of privity of contract in the original Uniform

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[305] Maraist & Barksdale, *supra* note 2, at 167 n.159.

[306] *See* Comment, *Res Ipsa Loquitur—A New Paradox in Blasting Cases*, 28 U. CHI. L. REV. 762 (1961).

[307] Lee v. Coca Cola Bottling Works, Inc., 236 Miss. 77, 80-81, 109 So. 2d 555, 556 (1959).

[308] Coca Cola Bottling Works v. Lyons, 145 Miss. 876, 885, 111 So. 305, 306 (1926).

[309] 211 So. 2d 833 (Miss. 1968).

[310] *Id.* at 837.

[311] Hamilton Fixture Co. v. Anderson, 285 So. 2d 744, 747 (Miss. 1973).

Commercial Code[312] has been broadened by recent legislation.[313] The seller's warranty is now apparently not limited to the buyer, persons in his family or household, or guests in his home. The warranty may be extended to impose liability on a manufacturer who sells the product to a retailer, thus permitting the injured retail purchaser to proceed directly against the manufacturer. In light of this expansion, warranty principles will perhaps be more readily applied, not merely as a secondary or tertiary line of attack, but, in a proper case, as a primary basis of recovery.[314]

V. Conclusion

Prior to the landmark *State Stove* decision in 1966, reliance upon general negligence principles, especially through the doctrine of res ipsa loquitur, was well placed, both within and without the then limited field of products liability. Subsequently, the increasing reliance placed upon the theory of strict liability in tort, in many instances to the total exclusion of negligence as a basis for recovery, has spawned a host of complex and frustrating problems for the Mississippi bench and bar in products liability cases, not the least of which center on the difficulties in pleading and proof. Beyond the ever-burgeoning field of products liability, res ipsa should be considered in its proper light as a cautiously applied, yet often vital, method of proof by circumstantial evidence. In any event, the doctrine is a means by which a number of problems relating to proof and ultimate liability may be obviated, whether through use of the doctrine as an alternative basis for recovery or through reliance upon the doctrine in cases where recovery under the theories of express or implied warranty or strict liability in tort might be precluded altogether.

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[312] *See* Miss. Code Ann. § 75-2-318 (1976).

[313] Act of Apr. 26, 1976, ch. 385, 1976 Miss. Laws 977.

[314] *See generally* Maraist & Barksdale, *supra* note 2, at 152-53.

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COMMENTS

APPRECIATED PROPERTY AS A SOURCE OF DIVIDENDS: ITS USE AND EFFECTS IN MISSISSIPPI

In this era of extreme inflationary pressures, most corporations possess an alternative source of dividends which, under some circumstances, offers distinct advantages over the traditional cash distribution from earnings. Utilization of a corporation's appreciated assets as a dividend source facilitates not only the transfer of greater value to the stockholders, but also may create an extra reserve for cash dividends when corporate surplus is low. Additionally, the tax advantages accuring to both the corporation and the shareholder under this in-kind[1] approach are often more favorable than those arising from the distribution of a cash dividend.[2] Nevertheless, a corporation considering an in-kind distribution will be confronted with a number of problems which, despite legislative enactments[3] and judicial review,[4] remain unsolved.

When cash is distributed as a dividend, the corporate and tax law consequences are relatively easy to determine.[5] In-kind distributions of corporate property, however, present additional problems which become especially acute when the dividend is composed of assets that have

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[1] The term property dividend, or dividend in-kind, will be used in this Comment to denote a dividend in property other than money or the distributing corporation's own stock or debt. B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶7.20 (3d ed. 1971); *see* E. DONALDSON & J. PFAHL, CORPORATE FINANCE 616 (2d ed. 1963).

[2] See section II. *infra*.

[3] *See* I.R.C. § 311; ALASKA STAT. §§ 10.05.201 to -.024 (1968); 1973 Ky. Rev. Stat. & Rules Serv. ch. 271A.225 (Baldwin); MISS. CODE ANN. § 79-3-83 (1972); NEB. REV. STAT. § 21-2043 (Cum. Supp. 1965); N.M. STAT. ANN. § 51-24-43 (Cum. Supp. 1975); ABA-ALI MODEL BUS. CORP. ACT § 45 (1969); *cf.* ALA. CODE tit. 10, § 21(55) (Cum. Supp. 1972) (permits restriction of dividends in the articles of incorporation); S.C. CODE §§ 12-15.14 (Cum. Supp. 1975) (expressly provides that dividends may be declared in shares of other corporations).

[4] *See* United States v. Cumberland Pub. Serv. Co., 338 U.S. 451, 455-56 (1950) (sale of corporate assets by shareholders after distribution does not result in gain to corporation unless corporation involved in the negotiations); General Util. & Operating Co. v. Commissioner, 296 U.S. 200, 206 (1935) (distributing corporation does not realize gain from distribution of appreciated stock); Hines v. United States, 477 F.2d 1063, 1065 (5th Cir. 1973) (distributing property to shareholders to be sold does not cause corporate gain from the sale).

[5] *See* I.R.C. §§ 301, 306, 317; MISS. CODE ANN. §§ 79-3-83, -85 (1972); Treas. Reg. § 1.316-1 (1955); B. BITTKER & J. EUSTICE, *supra* note 1, at ¶¶7.01 *et seq.*; J. BONBRIGHT, THE VALUATION OF PROPERTY ch. 27 (1937); W. CAREY, CASES AND MATERIALS ON CORPORATIONS 1484 (4th ed. 1969); W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 5318 *et seq.* (rev. perm. ed. 1971).

appreciated in value to a point above that listed in the corporate accounts. Specifically, several recurring issues arise: Does a dividend of appreciated property create a gain for the distributing corporation? If it does, how much of the gain must be reported for tax purposes? And, if it does not create an immediate gain, does a sale of the property by the shareholder shortly after the distribution cause the gain in that transaction to be attributed to the corporation? Finally, is there an alternative to an in-kind dividend that will transfer the gain from appreciated property to the shareholder while still permitting the corporation to retain ownership of such property?

In attempting to answer these and other related questions, this Comment will initially explore the corporate law concepts which surround in-kind dividends of appreciated property, focusing primarily upon the treatment of such distributions under Mississippi's Model Business Corporation Act.[6] Secondly, an overview of the income tax consequences of an appreciated property dividend will be made in conjunction with an analysis of its effect upon corporate earnings.[7] Finally, the author will examine the three methods of distributing a dividend from appreciated property and will suggest two preferred approaches in light of the existing corporate and tax laws.

I. Corporate Law Concepts

Absent any other personal motivation, the most important consideration to the typical corporate investor is the return he can expect to receive on his invested capital. Although the form of the return may theoretically assume several forms, *e.g.*, a salary, interest on a debt obligation or appreciation of stock value with gain realization to occur upon sale,[8] the most common vehicle for investment return is the dividend.

A dividend is generally defined as a portion of the corporate profits conveyed to the shareholders in cash or in other corporate property.[9] When a cash dividend is declared, the corporation becomes a debtor to

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[6] Miss. Code Ann. §§ 79-3-1 *et seq.* (1972).

[7] It is important to keep each section of this Comment in its proper perspective. Corporate law governs the "when and how much" of dividend distribution. A corporation's board of directors draws its power to declare and pay dividends from that body of law. *See, e.g.*, Miss. Code Ann. § 79-3-83 (1972), which provides in pertinent part: "The board of directors of a corporation may pay dividends on its outstanding shares in cash, property, or its own shares . . . ." Income tax law, on the other hand, simply determines the tax treatment of such dividends. *See* I.R.C. §§ 311, 312.

[8] *See* H. Guthman & H. Dougal, Corporate Financial Policy 65, 97-100, 115-17 (4th ed. 1962); *cf.* E. Donaldson & J. Pfahl, *supra* note 1, at 412-40 (discussion of the computation of return on capital, cost of capital and methods of capital investment).

[9] H. Henn, Law of Corporations § 318 (2d ed. 1970).

its shareholders and is bound to discharge the obligation in lawful currency.[10] However, simply because the distribution is termed a "cash" dividend does not prohibit satisfaction of the debt through an in-kind payment agreed to by the shareholder.[11] Although an in-kind dividend also creates a debtor-creditor relationship, it is declared in terms of the property itself[12] and, consequently, no cash equivalency debt arises. The property distributed in an in-kind dividend is usually securities issued by other corporations and held for investment,[13] although land,[14] inventory[15] or any other property asset may be dispersed. Finally, declarations can be divided for each share of stock, *e.g.*, two shares of IBM stock granted on each share of common stock, or property may be distributed as a tenancy in common with each shareholder receiving the same

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[10] *See* W. FLETCHER, *supra* note 5, at § 5356.

[11] The distribution of property to satisfy a dividend debt may be considered a taxable event in which the corporation must recognize a gain or loss. *See, e.g.*, Callanan Road Improvement Co., 12 B.T.A. 1109 (1928). The tax treatment of this type of transaction is discussed in notes 110 through 114 and accompanying text *infra*.

[12] The declaration of a property dividend is far from a mysterious process and, simply stated, is little more than a substitution of words. Thus, instead of declaring a dividend for $X per share, the corporation simply distributes X amount of property per share or as a tenancy in common.

[13] While it is true that property dividends usually take the form of a securities distribution, the context in which the distribution is made need not follow any particular pattern. Public utility holding companies, for example, have distributed securities to their shareholders in the course of complying with certain requirements of the Public Utility Holding Company Act of 1958, 15 U.S.C. §§ 79a *et seq.* (1970). E. DONALDSON & J. PFAHL, *supra* note 1, at 616. Similarly, a corporation which is ordered to divest itself of securities of other corporations for violations of the antitrust laws may achieve the dividend through an in-kind distribution of the shares to its shareholders. *Cf.* Veneer v. Southern Pac. Co., 279 F. 832 (2d Cir.), *cert. denied*, 258 U.S. 628 (1922) (offer of securities to shareholders at less than fair market value under the provisions of a divestment order). Additionally, some corporations have distributed government bonds which had been held for investment. *E.g.*, Parkersburg Iron & Steel Co. v. Commissioner, 17 B.T.A. 74, 75-76 (1929). Since securities are now utilized in terms of appreciated value to determine whether a corporation has unreasonably accumulated earnings, the former advantage of holding securities at cost has ceased to exist. Some corporations will thus be faced with the choice of distributing the stock or risking imposition of a penalty tax. *See* Golconda Mining Co. v. Commissioner, 58 T.C. 736 (1972); I.R.C. §§ 531-37. Finally, the recapture of depreciation accords securities a unique treatment. Securities may generally be distributed with no recognizable tax gain to the corporation—a distinct advantage possessed by few other assets. *See* notes 105 through 108 and accompanying text *infra*.

[14] *E.g.*, Hines v. United States, 477 F.2d 1063, 1066 (5th Cir. 1973); Poole v. Commissioner, 251 F.2d 233, 239 (9th Cir. 1957); Earle Real Estate Co. v. Commissioner, 6 T.C.M. (CCH) 667, 667 (1947); *cf.* Nemours Corp. v. Commissioner, 6 T.C.M. (CCH) 820, 821 (1947) (land and stock distributed to shareholders in proportion to ownership interests).

[15] *E.g.*, United States v. Lynch, 192 F.2d 718, 719 (9th Cir. 1951), *cert. denied*, 343 U.S. 934 (1952) (apples); Louisiana Irrigation & Mill Co. v. Commissioner, 14 T.C.M. (CCH) 1252, 1252 (1955) (rice).

proportionate ownership in the property that he has in the corporation.[16] In this instance, of course, the differing needs of each shareholder to either hold or sell the property necessitates that the latter form of distribution be employed either in a closely held corporation or where the property is to be sold shortly after distribution.[17]

Regardless of its form, the authority to declare any dividend is vested in the discretion of the corporation's board of directors.[18] This discretion, however, is not unlimited. If a dividend is declared contrary to statute, the directors voting in favor of it will be, in the case of a cash dividend, liable to the corporation for any amount paid in excess of that permitted under the statute.[19] In the case of an illegal in-kind dividend,

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[16] *See* Hines v. United States, 477 F.2d 1063, 1065 (5th Cir. 1973); Poole v. Commissioner, 251 F.2d 233, 239 (9th Cir. 1957); Interstate Realty Co. v. Commissioner, 25 B.T.A. 728, 730 (1932); *cf.* Commissioner v. First State Bank, 168 F.2d 1004, 1005 (5th Cir.), *cert. denied*, 335 U.S. 867 (1948) (proceeds of delinquent promissory notes eventually collected paid to shareholders).

[17] A tenancy in common would be unworkable for any extended period of time among large numbers of persons. Indeed, the varying needs of the different shareholders may cause one or more to demand a partition or some other end to the agreement. Only where the shareholders are a small, cohesive group would a tenancy in common be expected to endure.

[18] MISS. CODE ANN. § 79-3-83 (1972). *See also* United States v. Gates, 376 F.2d 65, 76 (10th Cir. 1967).

[19] *See* MISS. CODE ANN. § 79-3-91(a) (1972) which provides:

> Directors of a corporation who vote for or assent to the declaration of a dividend or other distribution of the assets of a corporation to its shareholders contrary to the provisions of this chapter or contrary to any restrictions contained in the articles of incorporation, shall be jointly and severably liable to the corporation for the amount of such dividend which is paid or the value of such assets which are distributed in excess of the amount of such dividend of distribution which could have been paid or distributed without a violation of the provisions of this chapter or the restrictions in the articles of incorporation.

See also Aiken v. Insull, 122 F.2d 746, 753 (7th Cir. 1941); Guarantee Reserve Life Ins. Co. v. Holzwarth, 148 Colo. 379, 366 P.2d 377, 383 (1961); *cf.* Metzger v. Joseph, 111 Miss. 385, 392, 71 So. 645, 647-48 (1916) (pre-section 79-3-91 decision in which a director's liability for voting in favor of an illegal dividend was placed at the full value of the dividend even though termed remedial).

A director will not be liable, however, if he relied in good faith upon a financial officer or accounting firm in determining the amount available for distribution as a dividend. MISS. CODE ANN. § 79-3-91(e) (1972); *see* Blythe v. Enslen, 209 Ala. 96, 95 So. 479, 481 (1922) (dividends paid by bank that impaired stock held not recoverable from directors for failure to show that they had not acted in good faith); Henry v. Wellington Tel. Co., 76 Ohio App. 77, 63 N.E.2d 233, 236 (1945) (unlawfully paid dividends by telephone company not recoverable from directors in a derivative suit if directors acted in good faith); Selheimer v. Manganese Corp., 423 Pa. 563, 224 A.2d 634, 641 (1966) (defining good faith as the diligence, care and skill which ordinary prudent men would exercise under similar conditions in personal business affairs); *cf.* Moerman v. Zipco, Inc., 302 F. Supp. 439, 337-48 (E.D.N.Y. 1969) (sale of stock by directors acting in "good faith" does not violate securities law even though third party misrepresented material facts); Whitlock

the potential liability is the difference between the amount which could lawfully have been paid and the value of the distributed property.[20]

A. *Earned Surplus*

Earned surplus[21] is the heart of any discussion of corporate dividends since the source of dividends is generally limited to unreserved and unrestricted[22] earned surplus.[23] Surplus is defined by the Mississippi Business Corporation Act as "the excess of the net assets of a corporation over its stated capital."[24] Additionally, surplus is divided into capital surplus and earned surplus, with earned surplus being defined as

> the portion of the surplus of a corporation equal to the balance of its net profits, income, gains and losses from the date of incorporation or

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v. Alexander, 160 N.C. 465, 76 S.E. 538, 541-42 (1912) (stock dividend issued in good faith is presumed to be valid).

[20] *See* MISS. CODE ANN. § 79-3-91(a) (1972). "Value" is not defined in the Mississippi Business Corporation Act. For an analysis of whether the term should be construed to mean "fair market value" or "book value," see notes 47 through 50 and accompanying text *infra*.

[21] Earned surplus is available for the payment of dividends in all American jurisdictions either by statute or case law. H. HENN, *supra* note 9, at § 320. In Mississippi, earned surplus is the only source of dividends. *See* MISS. CODE ANN. §§ 79-3-83, -85 (1972).

Historically, the source of dividends was a corporation's net profits, *see* Hackney, *The Financial Provisions of the Model Business Corporation Act*, 70 HARV. L. REV. 1357, 1359-63 (1957), and a number of states continue to adhere to this approach, *e.g.*, ARIZ. REV. STAT. § 10-196(A)(1) (1956). Indeed, in some states, dividends may be paid out of current net profits despite an impairment of capital. *See, e.g.*, NEV. REV. STAT. § 78.290 (1975); N.C. GEN. STAT. § 55-50 (1975). However, not all states that use the current net profits approach expand the concept to such an extreme. *See, e.g.*, DEL. CODE ANN. tit. 8, § 170 (1967); KAN. STAT. §§ 17-3501, -3502 (1963).

[22] The term "unreserved" seeks to exclude from dividend distribution certain earned surplus reserves which may be created and abolished by the board of directors for a multitude of purposes. The directors' power to reserve earned surplus is derived from section 67 of the Model Act. *See* MISS. CODE ANN. § 79-3-139 (1972). *See generally* Seward, *Sources of Distributions to Shareholders*, 5 BAYLOR L. REV. 242, 252 (1953). The term "unrestricted" is designed to exclude from potential dividends any earned surplus restricted by a redemption of stock, liquidation preferences or cumulative preferred stock dividends. Furthermore,

> restrictions may arise from contractual agreements with creditors [as for example] in an indenture or in a bank loan agreement. Typically such a restriction might limit dividends to earned surplus in excess of a specified amount.

ABA-ALI MODEL BUS. CORP. ACT § 45a, Comment (1969).

[23] *See* MISS. CODE ANN. § 79-3-83 (1972); *cf. id.* § 79-3-85. Section 79-3-85 provides that distributions from capital surplus may be made only when the shareholders vote for such a distribution or, assuming such authority is granted in the articles of incorporation, the directors declare a dividend. Significantly, however, only property may be distributed from this source. *Id.* § 79-3-87; *see* Hodge & Perry, *The Model Business Corporation Act: Does the Mississippi Version Lime the Bushes?*, 46 MISS. L.J. 371, 375-79 (1975).

[24] MISS. CODE ANN. § 79-3-3(1) (1972).

> from the latest date when a deficit was eliminated by an application of its capital surplus or stated capital or otherwise, after deducting subsequent distributions to shareholders and transfers to stated capital and capital surplus to the extent such distributions and transfers are made out of earned surplus.[25]

Stated another way, earned surplus is "the net cumulative balance of profits and losses."[26] Dividends are simply distributions from earned surplus.[27]

When a cash dividend is declared and paid, both the cash and the earned surplus accounts on the balance sheet are reduced by the amount of the dividend. For example, assume the following balance sheet accounts:

Balance Sheet of ABC, Inc.

Assets		*Capital and Liabilities*	
Cash	2000	Accounts Payable	500
Land	500	Stated Capital	1000
Other Assets	2500	Capital Surplus	1000
Total Assets	5000	Earned Surplus	2500
		Total Capital and Liabilities	5000

Assume further that a $1,000 cash dividend is declared and paid. When the cash and earned surplus accounts are reduced by the amount of the dividend, the balance sheet will appear as follows:

Balance Sheet of ABC, Inc.

Assets		*Capital and Liabilities*	
Cash	1000	Accounts Payable	500
Land	500	Stated Capital	1000
Other Assets	2500	Capital Surplus	1000
Total Assets	4000	Earned Surplus	1500
		Total Capital and Liabilities	4000

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[25] *Id.* § 79-3-3(m).

[26] Hackney, *supra* note 21, at 1365-66; *see* Seward, *Earned Surplus—Its Meaning and Use in the Model Business Corporation Act*, 38 VA. L. REV. 435, 437 (1952).

[27] *See* Seward, *supra* note 26, at 438.

Alternatively, if the land had been distributed as a dividend in-kind, the same procedure would be followed. In other words, the land account would be reduced by the property's book value and the earned surplus account would be reduced by $500. Thus, after the declaration and distribution of the property dividend, the balance sheet would be:

Balance Sheet of ABC, Inc.

Assets		*Capital and Liabilities*	
Cash	2000	Accounts Payable	500
Land	—0—	Stated Capital	1000
Other Assets	2500	Capital Surplus	1000
Total Assets	4500	Earned Surplus	2000
		Total Capital and Liabilities	4500

The balance sheet, however, lists assets in terms of their purchase price rather than at their current fair market value. Consequently, the actual value of the property to the corporation is not reflected.[28] The land could have greatly appreciated in value without that fact ever being shown on the corporation's balance sheet.[29] This omission is particularly important to the corporation's earned surplus account. For instance, assume that in the last example the land's fair market value is $1,000. By declaring a dividend in-kind instead of cash, the corporation would maintain its earned surplus account $500 above what it would have been had cash been distributed, while still paying its shareholders the same $1,000 value.

The advantages of employing appreciated property as a dividend source are further accentuated in situations where the corporation's low level of earned surplus effectively prohibits the declaration of a cash dividend. For example, assume that in the above hypothetical the earned surplus account indicated a $500 balance instead of a $2,500 balance. Under the general rule that a corporation is authorized to pay dividends only to the extent of its unreserved and unrestricted earned surplus,[30] the corporation could only distribute a $500 cash dividend to its stockholders. By distributing the appreciated land worth $1,000 to the stockholders, management may effectively circumvent the earned

[28] *See* P. Mason, S. Davidson & J. Schindler, Fundamentals of Accounting 30 (4th ed. 1959).

[29] An appreciation in land value, although not shown on the balance sheet, creates income tax consequences that must be considered before a decision to distribute the property is made. For a discussion of these consequences, see section II. *infra*.

[30] See note 22 and accompanying text *supra*.

surplus restriction and give a greater return to its investors.

Another aspect of earned surplus concerns the payment of cash dividends with appreciated property. The payment of a corporate debt with appreciated property creates earnings to the corporation to the extent that the market value of the property exchanged for the debt exceeds the property's book value.[31] Thus, earned surplus is increased by that difference. As previously noted, once a corporation declares a cash dividend it assumes the status of a debtor and must discharge the debt.[32] If the debt to its shareholders is satisfied through an appreciated property dividend instead of cash, the exchange results in the same type of earnings created by the payment of an ordinary corporate debt.[33] This analysis is perhaps best illustrated by an examination of the accounting procedures which accompany such a transaction.

The declaration of a cash dividend initially requires a reduction of the earned surplus account by the amount of the dividend. The property account, however, which is the source of the in-kind payment of the cash dividend, is only reduced by the property's book value. Since the book value of appreciated property is less than its market value, an imbalance in the respective sides of the balance sheet results such that assets will exceed capital and liabilities by the difference between the property's book and market values. To restore the required balance, earnings must be recorded to the extent the dividend debt exceeds the property's book value. Although this is not a particularly significant problem, the result is an increase in the corporation's annual earnings.

B. Insolvency

A corporation may pay dividends only if two preliminary limitations are satisfied. First, a dividend may be declared only to the extent of unreserved and unrestricted earned surplus.[34] Second, no dividend may be declared either "when the corporation is insolvent or when the payment would render the corporation insolvent."[35] The Mississippi Business Corporation Act defines insolvency as the inability to pay debts as they become due in the ordinary course of business.[36] This condition is

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[31] *Cf.* Davis v. United States, 370 U.S. 65 (1962) (payment by taxpayer of debt with appreciated property).

[32] See note 10 and accompanying text *supra*.

[33] The question of the corporation's obligation to report this gain for income tax purposes is discussed in notes 109 through 114 and accompanying text *infra*.

[34] See notes 22 & 23 and accompanying text *supra*.

[35] MISS. CODE ANN. § 79-3-83 (1972); *accord, id.* §§ 79-3-85, -87 (section 79-3-85 limits any distribution from capital surplus when insolvent; section 79-3-87 restates the section on dividends from earned surplus).

[36] *Id.* § 79-3-3(o).

commonly referred to as equity insolvency.[37] As previously noted in another context, should a violation of the insolvency restrictions occur, the difference between the amount of the dividend which could have been paid without a violation and the amount actually distributed may be recovered either from the corporation's directors or from the stockholders if they had knowledge of the insolvency.[38]

Apart from the specific corporate dividend statutes, the Bankruptcy Act[39] has significant bearing upon the propriety of dividend payments.[40] In general, the Bankruptcy Act condemns dividend payments when their effect is either to force the corporation into insolvency or to leave it with "unreasonably small capital."[41] Such payments are classified by the Act as fraudulent transfers without regard to intent.[42] Moreover, the trustee in bankruptcy is vested with the title to any bankrupt corporation's property and succeeds to any cause of action it may have against the directors and shareholders for the declaration or receipt of

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[37] *See* Kriedmann, *Dividends—Changing Patterns*, 57 COLUM. L. REV. 372, 374 (1957).

[38] *See* Wood v. National City Bank, 24 F.2d 661, 662 (2d Cir. 1928); Fried v. Como, 167 F. Supp. 625, 629 (S.D.N.Y. 1958) (shareholder can be held liable if he knew that dividends were paid while the corporation was insolvent); Gray v. Sutherland, 268 P.2d 754, 759 (Cal. App. 1954) (shareholder withdrawals recoverable by corporation if made while corporation insolvent); Alliegro v. Pan Am. Bank, 136 So. 2d 656, 659-60 (Fla. Dist. Ct. App. 1962) (dividend recoverable from majority shareholder if paid to him with his knowledge of its impropriety); Metzger v. Joseph, 111 Miss. 385, 389-91, 71 So. 645, 647-48 (1916) (recovery allowed from bank directors); Kretschmar v. Stone, 90 Miss. 375, 379, 43 So. 177, 177 (1904) (suit to recover from shareholders allowed); Webb City Undertaking Co. v. Sinclair, 240 Mo. App. 958, 225 S.W.2d 138, 143-44 (1949) (illegal dividends paid to shareholder are recoverable if shareholder had knowledge of the impropriety).

[39] Bankruptcy Act §§ 1 *et seq.*, 11 U.S.C. §§ 1 *et seq.* (1970).

[40] The Comments to section 45 of the Model Act, from which Mississippi's dividend statute was directly taken, explain:

> The term "insolvency" is defined in section 2(n) [§ 79-3-3(o)] to mean inability to pay debts as they become due. It is a cash flow test in the equity sense of insolvency, rather than a value test as used in the Bankruptcy Act. The value test, however, is also imposed by the provision that dividends must be limited to earned surplus since by the definitions in section 2 [§ 79-3-3] there is no earned surplus unless net assets exceed stated capital.

ABA-ALI MODEL BUS. CORP. ACT § 45, Comment (1969).

[41] See Bankruptcy Act § 67d, 11 U.S.C. § 107(d)(2) (1970), providing in part:

> Every transfer made and every obligation incurred by a debtor within one year prior to the filing of a petition . . . is *fraudulent* . . . as to then existing creditors and as to other persons who become creditors during the continuance of a business or transaction, if made . . . without fair consideration by a debtor . . . for which the property remaining in his hands is an *unreasonably small capital*, without regard to his actual *intent* . . . .

(emphasis added); *see* Sparling v. General Discount & Mortgage Corp., 178 Wash. 663, 391 P.2d 60, 62 (1935).

[42] Bankruptcy Act § 67d, 11 U.S.C. § 107(d)(2) (1970).

improper dividends.[43] Finally, the trustee may consider null and void any transfer which, under any federal or state law, is "fraudulent as against or voidable for any other reason by any creditor."[44]

Bankruptcy insolvency exists whenever a corporation's debts exceed its assets and therefore it is essentially a value test. Since Mississippi restricts a corporation's source of dividends to earned surplus,[45] a fundamental question thus arises as to whether dividends may be declared and distributed from earned surplus when a corporation has fallen into bankruptcy insolvency. Although this situation is most often obtained when a corporation has overvalued or "watered" its assets,[46] a similar situation may arise in the context of an in-kind distribution.

Because a property distribution normally does not affect a corporation's ability to pay its debts, equity insolvency is usually avoided. Consequently, a property dividend would most likely be questioned in the context of bankruptcy insolvency. For example, assume the following balance sheet wherein the fair market value of each asset is indicated parenthetically.

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[43] Bankruptcy Act § 70d, 11 U.S.C. § 110(d) (1970); *see* Superintendent v. Bankers Life & Cas. Co., 404 U.S. 6, 10-11 (1971); Harrigan v. Bergdoll, 270 U.S. 560, 564 (1926); *cf.* Branch v. Steph, 389 F.2d 233, 235 (8th Cir. 1968) (personal debt owed by shareholder and paid by corporation set aside in a suit by bankruptcy trustee); McConnico v. Third Nat'l Bank, 499 S.W.2d 874, 888 (Tenn. 1973) (trustee authorized to set aside fraudulent transfers made by bankrupt corporation). *See also* Martin v. Clark, 95 F.2d 26 (7th Cir. 1938), *cert. denied*, 304 U.S. 584 (1939).

[44] Bankruptcy Act § 70e, 11 U.S.C. § 110(e) (1970); *see* Stellwagon v. Clum, 245 U.S. 605, 617-18 (1918); Heffron v. Duggins, 115 F.2d 519, 520 (9th Cir. 1940). In conjunction with the state limitations on declaring dividends while equitably insolvent, the Act empowers the trustee to recover any payments made during such insolvency. *Cf.* Autrey Bros., Inc. v. Chichester, 240 F.2d 498, 501-02 (9th Cir. 1957) (transfer by a corporation not in compliance with state bulk sales law declared a hindrance to other creditors and set aside); Feist v. Druckerman, 70 F.2d 333, 335 (2d Cir. 1934) (conveyance while insolvent violated state law and was set aside); Lincoln Theatres Corp. v. Fleming, 66 F.2d 441, 446 (4th Cir. 1933) (federal courts bound to accept state court interpretations regarding the validity of property transfers).

[45] MISS. CODE ANN. § 79-3-83 (1972).

[46] Watered assets are assets listed on the corporation's books at a value greater than their fair market value. In Goodnow v. American Writing Paper Co., 73 N.J. Eq. 692, 69 A. 1014 (1908), the book value of the corporation's assets exceeded the fair market value. More importantly, the fair market value of the assets did not equal the aggregate of the corporation's par value stock and outstanding debt. Nevertheless, the company did have current net profits, a permissible dividend source under the existing law. Despite the presence of net profits, the court, in order to protect the creditors of the corporation, refused to allow any dividend payments until the company's assets equaled the aggregate of the capital stock and outstanding debt. 69 A. at 1016.

Balance Sheet of DEF, Inc.

Assets			*Capital and Liabilities*	
Cash	500	(500)	Liabilities	1000
Land	500	(1500)	Stated Capital	1000
Other Assets	1500	(400)	Earned Surplus	500
Total Assets	2500	(2400)	Total Capital and Liabilities	2500

In this situation, distribution of the land as an in-kind dividend would not render the corporation insolvent in the equity sense. The corporation has, however, become insolvent under the Bankruptcy Act since its capital and liabilities exceed its assets. Consequently, if the corporation is forced into bankruptcy, the trustee will have the authority to declare the dividend null and void if the transfer was in any way fraudulent or otherwise voidable by any of the corporation's creditors.[47] Should the bankruptcy trustee seek to recover the value of the distributed property from the directors and stockholders, however, the issue will surely be raised as to whether book value or market value should be assigned to the property at the time liability is determined. In this respect, Mississippi's Business Corporation Act is of little assistance since a standard for such value is not prescribed within its definitional framework. Book value, however, is clearly not determinative.[48] Surely the courts would not allow dividends in highly appreciated property to be wrongly declared and then only find the directors liable for the difference in the property's book value and the earned surplus available for dividends.[49]

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[47] Bankruptcy Act § 67d, 11 U.S.C. § 107(d) (1970).

[48] *See* Garrett, *Capital and Surplus Under the New Corporation Statutes*, 23 LAW & CONTEMP. PROB. 239, 258 (1958) (discussing the same provisions from the Model Act); Seward, *supra* note 26, at 440.

[49] As an illustration of why the liability would probably not be measured by book value, assume the following facts. A corporation declared and distributed property with a fair market value of $10,000 and a book value of $3,000. The amount available for dividends was $2,000. Subsequently, the corporation became bankrupt and the trustee sued the directors for damages on the illegal dividend. If the courts were to fix the director's liability at the difference in book value of the property and the amount available for a dividend, the liability would be $1,000. However, $6,000 would have been siphoned off without the statute providing for a remedy in state courts. Therefore, to hold the directors completely liable for their wrongdoing, the courts would have to define "value" as fair market value.

To further bolster this definition of "value," it should be noted that the drafters of section 79-3-91 made a distinction by specifically using "book value" in subsection (e) and by not stating a standard in subsection (a). This could lead to the conclusion that "value" was intended to mean something other than "book value."

Thus, in a bankruptcy context, several valuation methods should be implemented before determining liability.[50]

C. *The Use of Appreciated Assets to "Write Up" Earned Surplus*

The problems associated with using appreciated assets to "write up" or increase a corporation's earned surplus are best illustrated by a rather simple hypothetical. Assume that the tangible assets of a corporation, all of which are vital to its continuing operation, have appreciated in value to levels above those listed on the balance sheet. Assume further that the corporation's board of directors has a pressing need to distribute a dividend to the shareholders, but the corporation lacks the required unrestricted and unreserved earned surplus legally to make such a distribution. The following balance sheet, wherein the fair market value of each asset is indicated parenthetically, is illustrative of this situation:

Balance Sheet of GHI, Inc.

Assets			*Capital and Liabilities*	
Cash	2,000	(2,000)	Liabilities	10,000
Machinery	4,000	(6,000)	Stated Capital	3,000
Land & Bldg.	7,000	(12,000)	Earned Surplus	—0—
Total Assets	13,000	(20,000)	Total Capital and Liabilities	13,000

Given these facts under Mississippi's Business Corporation Act, may the directors increase the book value of the assets to fair market value, thus increasing the earned surplus by an equal amount, and declare a cash dividend from that earned surplus? If the corporation is permitted to make the increases, it will realize many benefits. For example, writing up would permit the corporation to maintain a good dividend record, prevent any cumulative preferred stock arrearage and share the benefits of bargain purchases of assets with its shareholders before resale. Additionally, if the corporation has no earnings and profits, it can distribute dividends that will not be taxed as ordinary income.[51] Thus, the benefits

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[50] *Cf.* D. HERWITZ, BUSINESS PLANNING 340 (1966) (discussing the various methods of property valuation).

[51] *See* District of Columbia v. Oppenheimer, 301 F.2d 563, 563-64 (D.C. Cir. 1962) (unrealized appreciation in value of property held by corporation for income not a taxable dividend when distributed to shareholders); Commissioner v. Gross, 236 F.2d 612, 615-18 (2d Cir. 1956) (dividends paid after a write up of assets did not come from earnings and profits and thus were treated as a return of capital); *cf.* Marx v. Bragalini, 6 N.Y.2d 322, 160 N.E.2d 611 (1959). In *Marx*, the corporation had refinanced assets which had greatly

that a corporation may receive from writing up its assets are clear. The problem, however, is that the law governing such a write up is not so clear.

Any discussion of this problem must begin with an examination of the landmark New York case of *Randall v. Bailey*.[52] The corporation in *Randall* had written up several of its assets to conform with the values assigned to them by the local taxing commission.[53] From this write up, the directors distributed approximately $3 million in dividends.[54] Subsequently, the corporation's trustee in bankruptcy brought an action against the directors for allegedly distributing an improper dividend. In a classic description of the problem presented, the court framed the issue as being whether

> unrealized appreciation in value of fixed assets held for use in carrying on a corporate enterprise [may] be taken into consideration by directors in determining whether a corporate surplus exists from which cash dividends may be paid to shareholders.[55]

The court interpreted the existing New York statute[56] as imposing a capital impairment test, using the current value of assets in determining whether sufficient surplus exists from which dividends may be declared.[57] Determining from the facts that such a surplus did exist under this test, the court concluded that the directors were not liable for the dividends.[58]

Although *Randall* has been cited as the only significant decision on the problem of distributing cash dividends from unrealized apprecia-

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appreciated in value. Cash was then distributed to its shareholders. Because the corporation had no earnings and profits, the taxpayer was not taxed on the distribution as ordinary income, but instead as a return of capital. 160 N.E.2d at 616-18. For a further discussion of this topic see notes 163 through 166 *infra*.

[52] 288 N.Y. 280, 43 N.E.2d 43 (1942).

[53] 23 N.Y.S.2d 173, 178 (Sup. Ct. 1940), *aff'd*, 288 N.Y. 280, 43 N.E.2d 43 (1942).

[54] 23 N.Y.S.2d at 176.

[55] 228 N.Y. at 283, 43 N.E.2d at 44.

[56] The New York statute provided:

> No stock corporation shall declare or pay any dividend which shall impair its capital or capital stock, nor while its capital or capital stock is impaired, nor shall any such corporation declare or pay any dividend or make any distribution of assets to any of its shareholders . . . unless the *value* of its assets remaining after the payment of such dividend . . . shall be at least equal to the aggregate amount of its debts and liabilities including capital or capital stock . . . .

N.Y. Stock Corp. Law ch. 59, § 58 (Consol. Laws 1923), *quoted in* 288 N.Y. at 285, 43 N.E.2d at 45 (emphasis added).

[57] 288 N.Y. at 287-88, 43 N.E.2d at 46-47.

[58] *Id.* at 291, 44 N.E.2d at 49. New York subsequently amended its statutes to specifically exclude unrealized appreciation of assets from the earned surplus account. *See* N.Y. Bus. Corp. Law § 102(a)(6) (1963).

tion,[59] other jurisdictions have considered the issue in deciding tangential questions.[60] Moreover, at least two courts have approved the use of revalued assets in the redemption of a corporation's own stock.[61]

The Model Business Corporation Act[62] appeared several years after the *Randall* decision but did not specifically deal with the propriety of writing up assets. The drafters of the Model Act, who otherwise relied primarily upon the Illinois Corporation Act, specifically deleted the Illinois prohibition against using unrealized appreciation to distribute cash dividends.[63] Consequently, as acceptance of the Model Business Corporation Act has grown, questions have been raised as to whether it allows dividends to be distributed from written-up assets. Several commentators have discussed the question and the resulting division of opinion may be categorized as follows: (1) the write up is permissible but, under contemporary accounting principles, dividends should not be allowed;[64] (2) the adjustment is permitted for stock dividends only;[65] and (3) the adjustment is acceptable for all types of distributions.[66]

Despite existing support for recognizing unrealized appreciation,[67] accountants have reaffirmed the traditional view that assets should not be written up to reflect an appraisal above cost.[68] Additionally, the Securities and Exchange Commission (SEC) has continued a policy of

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[59] *See* D. HERWITZ, *supra* note 50, at 332.

[60] *See* Cannon v. Wiscasset Mills Co., 195 N.C. 119, 141 S.E. 344, 347-48 (1928) (in determining the amount available for dividends, a corporation should look to fair market value instead of the higher book value); Titus v. Piggly Wiggly Corp., 2 Tenn. App. 184, 194-97 (1925) (corporation may revalue assets if there is a tangible basis for revaluation, but only to prevent capital impairment and not to declare dividends). *But see* Woodson v. Lee, 73 N.M. 425, 389 P.2d 196, 201-02 (1963); *but cf.* Berks Broadcasting Co. v. Craumer, 356 Pa. 620, 52 A.2d 571, 574 (1947) (construing a Pennsylvania statute which prevented dividends from unrealized appreciation). *See also* Northwestern Elec. Co. v. Federal Power Comm'n, 321 U.S. 119, 124-25 (1944) (refused to allow write up of appreciated assets to cover earlier issue of watered stock although not addressing the question of whether it could be done for other purposes); Cunningham v. Jaffe, 251 F. Supp. 143, 146-47 (D.S.C. 1966) (fair market value test of insolvency should be used over book value).

[61] See Mountain States Steel Foundries, Inc. v. Commissioner, 284 F.2d 737, 741 (4th Cir. 1960); Baxter v. Lancer Indus., Inc., 213 F. Supp. 92, 95 (E.D.N.Y. 1963).

[62] ABA-ALI MODEL BUS. CORP. ACT (1953).

[63] *See* Bugge, *Unrealized Appreciation as a Source of Shareholder Distributions Under the Wisconsin Business Corporation Law*, 1964 WIS. L. REV. 292, 298; Hackney, *supra* note 21, at 1378.

[64] *See* D. HERWITZ, *supra* note 50, at 326-28; Hackney, *supra* note 21, at 1376-84.

[65] See Garrett, *supra* note 48, at 259 (the author gives no reason for his distinction between share dividends and cash dividends).

[66] See Bugge, *supra* note 63, at 296-98; Seward, *supra* note 26, at 440-41; *cf.* Gibson, *Surplus, So What?—The Model Act Modernized*, 17 BUS. LAW. 476, 486-87 (1962) (discussing use of current value of assets for distributing dividends).

[67] *See* D. HERWITZ, *supra* note 50, at 327-28.

[68] *See id.*

requiring that fixed assets be accounted at cost.[69] As a component of certain filing requirements, however, the SEC requires disclosure of any material increases or decreases in investments, property, plant and equipment, or intangible assets which result from major revaluations of such assets, within a period of seven years, for the purpose of entering current values, reproduction costs or any values other than the original cost in the corporate records.[70]

Like the Model Act, Mississippi's corporation act does not specifically prohibit the use of appreciated property in granting dividends. This is particularly noteworthy since many other state statutory schemes impose such a limitation.[71] The Mississippi Supreme Court, however, has considered a "revaluation surplus" account on one occasion in the context of franchise taxes. In *Scott Building Supply Corp. v. Mississippi State Tax Commission*,[72] the corporation had adjusted its accounts to conform with an appraisal by a federal corporation from which it was borrowing money.[73] An audit by the state tax commission revealed that the corporation had not included for calculation of its franchise taxes the "revaluation surplus" shown on the balance sheet.[74] The corporation argued that the surplus should not be taxed since it was not part of the original cost of the assets upon which the tax was to be based. Rejecting this argument, the court held that the "revaluation surplus" was taxable as part of the "surplus" intended to be taxed.[75] The court quoted with approval part of an opinion by Justice Brandeis which considered surplus not only to be paid-in surplus or earned surplus, but also the increase in value of assets made upon a revaluation of property.

> "The word 'surplus' is a term commonly employed in corporate finance and accounting to designate an account on corporate books . . . . The surplus account represents the net assets of a corporation in excess of all liabilities including its capital stock. This surplus may be 'paid-in surplus,' as where the stock is issued at a price above par; it may be 'earned surplus,' as where it was derived wholly from undistributed profits; or it may, among other things, represent the increase in valua-

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[69] *See* L. RAPPAPORT, SEC ACCOUNTING PRACTICE AND PROCEDURE §§ 3.9 to -.16 (2d rev. ed. 1966).

[70] *Id.* §§ 7.13, -.15.

[71] *See, e.g.*, CAL. CORP. CODE ANN. §§ 1502, 1505 (West 1955); ILL. ANN. STAT. ch. 32, § 157.41(c) (Smith-Hurd 1954) (limits use to stock dividends only); N.C. GEN. STAT. §§ 55-49(d), -(e) (1975) (prohibits use of unrealized appreciation as earned surplus but allows for capital surplus); OHIO REV. CODE ANN. § 1701.33(A) (Page 1964) (allows use of unrealized appreciation for share dividends only).

[72] 235 Miss. 22, 108 So. 2d 557 (1959).

[73] *Id.* at 27, 108 So. 2d at 559.

[74] *Id.*

[75] *Id.* at 36-37, 108 So. 2d at 563-64.

tion of land or other assets made upon a revaluation of the company's fixed property."[76]

Based on *Scott* and the definition of surplus found in the corporation act,[77] the reasonable inference is that "net assets" in the definition of surplus means fair market value, not book value. If this were true, any increase caused by appreciation of assets arguably would be placed in the capital surplus account rather than in the earned surplus account. This argument is founded upon the fact that capital surplus is considered the residue account[78] whereas earned surplus is defined in terms of "net profits, income, gains and losses." If the revaluation surplus did belong to capital surplus, it would have only limited usefulness in terms of dividend distribution.[79] Consequently, arguments for recording any revaluation surplus in the earned surplus account advance the views that appreciation is really a "gain" within the earned surplus definition[80] or that appreciation is actually reverse depreciation arising from the earned surplus.[81] Regardless of which balance sheet account revaluation is placed in, it should be noted that the *Scott* court accorded considerable emphasis to the fact that the appraisal was independent and did not result in overvaluation of the assets.[82] Furthermore, the court intimated that a revaluation based upon the subjective opinion of management might be subject to closer scrutiny.[83]

Beyond these problems, however, two interrelated business problems exist with respect to revaluation of appreciated assets. First, management must determine the appropriate value to be assigned to the asset. This valuation can be governed by a variety of methods, including second-hand reproduction cost, enterprise valuation based upon capi-

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[76] *Id.* at 36, 108 So. 2d at 563, *quoting* Edwards v. Douglas, 269 U.S. 204, 214 (1925).

[77] *See* MISS. CODE ANN. § 79-3-3(1) (1972).

[78] *See id.* § 79-3-3(n) (defined as including all the surplus of the corporation except earned surplus).

[79] *Compare* MISS. CODE ANN. § 79-3-85 (1972) *with id.* § 79-3-87. Section 79-3-85 states that distributions in cash or property may be made from capital surplus. Standing alone, however, this section conveys an inaccurate picture.

In the following section, 79-3-87, cash dividends are limited exclusively to earned surplus "notwithstanding" anything to the contrary in the Mississippi Business Corporation Act. The question of whether the term "cash" in section 79-3-87 can be construed to mean "cash or property" is left for judicial interpretation. If the court determines that property can be distributed from capital surplus, it would be a simple matter to convert cash to property and thereby circumvent any restriction arising from section 79-3-87. *See* Hodge & Perry, *supra* note 23, at 378-79.

[80] *See* MISS. CODE ANN. § 79-3-3(m) (1972); Seward, *supra* note 26, at 441-43.

[81] *See* D. HERWITZ, *supra* note 50, at 339; *cf.* Seward, *supra* note 26, at 441 (discussing diminution in value of assets and depreciation in a similar manner).

[82] 235 Miss. at 36-37, 108 So. 2d at 563.

[83] *Id.*

talization of earnings and the appraisal of each asset or class of assets.[84] The particular method chosen is important since it is rare that any two methods of valuation will produce the same value.[85] Consequently, the choice of a valuation method will have a direct impact upon the amount of the dividend to be distributed. Secondly, management could be faced with a problem of capital impairment resulting from dividends dispersed after revaluation.[86] Any revaluation creates the potential for overvaluation and a distribution of dividends which could impair capital. While the directors may not be liable for any such dividends paid in "good faith" reliance upon the financial statements,[87] the possibility that creditors will be defrauded in the process is very real.

II. Tax Consequences

Before the adoption of the 1954 Internal Revenue Code, few areas of tax law were more controversial than the income tax treatment of in-kind dividends.[88] Enactment of the 1954 Code, however, cooled much of this discussion. Consequently, the pre-1954 treatment of in-kind dividends will be referred to in this discussion only when background information is necessary to understand the present tax consequences.

This discussion of the tax law concepts associated with in-kind dividends will initially describe the effect of an appreciated property distribution upon the distributing corporation's income. Additionally, the effect of such a distribution upon the corporation's earnings and profits will be examined. Finally, unrealized appreciation and the writing up of assets will be discussed in terms of their taxability.

A. The Distributing Corporation's Gain or Loss

Prior to the enactment of the 1954 Code, substantial controversy existed as to whether a corporation should recognize a gain above its adjusted basis when it transferred appreciated property to its stockholders.[89] In adopting the 1954 Code,[90] Congress attempted to obviate much of this turmoil by including in section 311 a general rule that "no gain

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[84] *See* D. Herwitz, *supra* note 50, at 340.

[85] *Id.*

[86] Capital impairment results when the assets of the corporation exceed its liabilities but are less than the liabilities plus stated capital. H. Henn, *supra* note 9, at 651.

[87] *See* Miss. Code Ann. § 79-3-91 (1972).

[88] *See* B. Bittker & J. Eustice, *supra* note 1, at ¶ 7.20; Watts, *Recognition of Gain or Loss to a Corporation on a Distribution of Property in Exchange for its Own Stock*, 22 Tax Law. 161, 162 (1968). *See generally* Raum, *Dividends in Kind: Their Tax Aspects*, 63 Harv. L. Rev. 593 (1950).

[89] B. Bittker & J. Eustice, *supra* note 1, at ¶7.20.

[90] Internal Revenue Code of 1954, Pub. L. No. 83-767, 68A Stat. 3 (codified at 26 U.S.C. §§ 1 *et seq.* (1970)).

or loss shall be recognized to a corporation on the distribution, with respect to its stock, of . . . property."[91] Additionally, section 311 created exceptions to this general rule in cases where a corporation recognized a gain from distributions of certain types of inventory[92] or distributions of property where the liability assumed by the shareholders exceeded the corporation's adjusted basis in the property.[93]

1. General Tax Treatment of an In-Kind Dividend and the Statutory Exceptions

As an example of a situation in which the general rule of section 311 is likely to arise, assume the following hypothetical. A corporation owns $50,000 worth of investment securities which are causing it accumulated earnings tax problems and consequently must be disposed of to avoid the risk of having to pay a penalty tax.[94] The adjusted basis of the securities is $30,000. Retaining the proceeds from a sale of the securities will not solve the problem since the corporation would still have the same excess liquidity problems and, to make matters even worse, more earnings would be exposed to taxation.[95] Thus, assuming that no earned surplus problems exist, the stock or its proceeds should be distributed to the shareholders as a dividend. In making this distribution, the directors have two alternatives. First, the securities may be sold and the proceeds distributed, requiring the corporation to recognize a gain. Assuming the corporation's net income exceeds $50,000 a year, the tax on the gain would be at least $6,000.[96] Furthermore, the shareholders would

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[91] I.R.C. § 311(a).

[92] *Id.* § 311(b).

[93] *Id.* § 311(c).

[94] *See id.* §§ 531 to -37. The accumulated earnings tax is a penalty tax imposed on closely held corporations that accumulate earnings beyond the reasonable needs of the business. In determining if a corporation should be penalized, the IRS takes into consideration, among other factors, the appreciation of any investment securities above their adjusted bases. *See, e.g.*, Ivan Allen Co. v. Commissioner, 422 U.S. 617, 628-30 (1975) (marketable securities valued at net liquidity value in determining the reasonable needs of the business); Cheyenne Newspapers, Inc. v. Commissioner, 494 F.2d 429, 434-35 (10th Cir. 1974) (marketable securities considered in determining the reasonable needs of the business); Ready Paving & Constr. Co. v. Commissioner, 61 T.C. 826, 836-38 (1974) (interest bearing warrants held to be current assets causing the corporation accumulated earnings problems).

[95] In determining the accumulated earnings tax, a corporation's reasonable needs are calculated in computing the tax. The corporation's liquid assets requirement is one of the factors used in determining its reasonable needs. Smoot Sand & Gravel Corp. v. Commissioner, 241 F.2d 197, 206-07 (4th Cir.), *cert. denied*, 354 U.S. 922 (1957); Treas. Reg. § 1.535-3(b) (1959).

[96] The amount is based on the tax paid if the gain were the most advantageous to the corporation. The tax is computed by multiplying 30%, the best rate, see I.R.C. § 1201(a), times the $20,000 gain.

be required to recognize a gain for the entire $50,000 on their individual returns.[97] In sum, this alternative has distributed $50,000 to the shareholders, but at a cost of at least $56,000 to the corporation.[98] The corporation's second alternative is to distribute the securities as an in-kind dividend to the shareholders. Although this alternative allows the shareholders to receive the same value as under the first alternative, the cost to the corporation would only be the value of the securities since, under section 311, the corporation would not recognize any gain on the distribution.[99]

The general rule of section 311 does, however, have several statutory exceptions.[100] These exceptions are listed and explained below.

a. Liability in Excess of the Asset's Basis

If a corporation distributes property as a dividend and the shareholders assume a prior mortgage or lien on the property, the corporation must recognize a gain to the extent the liability exceeds the adjusted basis under the distributor's ownership.[101] Assume, for example, that a corporation distributes land as a dividend. Assume further that the land's adjusted basis is $5,000, its market value is $20,000 and the outstanding mortgage on the land is $15,000. In this situation, the gain to the corporation upon distribution is $10,000. However, if the fair market value of the land had been less than the outstanding mortgage, the gain would have been limited to the difference between the land's fair market value and its adjusted basis or $5,000.

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[97] The individual shareholders would be allowed the $100 dividend exclusion when reporting their income. I.R.C. § 116(a).

[98] The tax could be higher if the corporation had more than $25,000 in annual net income. I.R.C. § 11.

[99] See Mintz & Plumb, *Dividends in Kind—The Thunderbolts and the New Look*, 10 TAX L. REV. 41, 44 (1954). However, see the discussion on anticipatory assignment of income at notes 117 through 125 and accompanying text *infra*.

[100] The statutory exception found in I.R.C. § 311(d) with regard to redemption of stock with appreciated property will not be discussed in this Comment. *See generally* Watts, *supra* note 88. Additionally, there are two statutory exceptions not listed in the text. First, if a corporation uses the last-in, first-out (LIFO) method of inventorying, and inventory assets are distributed as dividends, section 311(b) requires the corporation to recognize a gain to the extent, if any, the LIFO value exceeds the basis determined by a non-LIFO method. *See* I.R.C. § 311(b); Treas. Reg. §§ 1.311-1(b), (c) (1955); Rev. Rul. 57-490, 1957-2 C.B. 231. Second, if a collapsible corporation distributes assets specified in section 341(f), the corporation must recognize gain upon the disposition. *See* I.R.C. § 341; Hall, *The Consenting Collapsible Corporation—Section 341(f) of the Internal Revenue Code of 1954*, 12 U.C.L.A.L. REV. 1365, 1373 (1965).

[101] I.R.C. § 311(c); *see* Treas. Reg. § 1.311-1(d) (1955); *cf.* I.R.C. § 357(c) (When a shareholder contributes property to the corporation in a tax-free exchange and the mortgage on the property exceeds the adjusted basis of the property in the hands of the shareholder, the shareholder must recognize gain to the amount of the excess.).

b. Installment Obligations

Section 453 of the Internal Revenue Code provides special tax treatment for any debts paid over a period of time greater than one year.[102] If no more than 30% of the debt is paid during the first year, the taxpayer is permitted to spread any gain received over the period of time allowed for repayment of the obligation.[103] Because of the progressive nature of our tax system, this spreading of the gain produces a tax savings to the taxpayer.

If a corporation distributes to its shareholders installment obligations subject to section 453 treatment, it must recognize a gain to the extent of the difference between the fair market value of the obligations and their basis at the time of distribution.[104] For instance, assume a corporation contracted to sell certain land with payments to be made in equal annual installments. If the installment obligation was distributed as a dividend to the corporation's sole shareholder, the corporation would be forced to recognize a gain. Assuming that the adjusted basis in the land was $5,000 and the fair market value of the obligation at the time of the dividend was $10,000, the corporation's gain would have been $5,000. To require the corporation to recognize a gain in this situation makes complete sense since nonrecognition would enable the corporation to exchange assets for installment obligations and distribute them to shareholders without ever recognizing a gain.

c. Depreciable Property[105]

"Section 1245 property" is defined as "any property which is or has been property of a character subject to . . . depreciation . . . and is . . . personal property."[106] Such property is generally the machinery and equipment of a business. If this property is distributed, the "recapture" rules will override the section 311(a) exemption and force recognition of gain to the distributing corporation.[107] Likewise, the "recapture"

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[102] See I.R.C. § 453; Treas. Reg. §§ 1.453-1 to -10 (1958); Emory, *Disposition of Installment Obligations: Income Deferral, "Thou Art Lost and Gone Forever,"* 54 IOWA L. REV. 945, 989 (1969).

[103] I.R.C. § 453(b).

[104] *See* I.R.C. § 453(d)(1); Treas. Reg. § 1.453-9 (1958); Interstate Realty Co. v. Commissioner, 25 B.T.A. 728, 735-36 (1932) (deferred payment notes distributed as dividend caused corporation to recognize gain on outstanding balance).

[105] *See* I.R.C. §§ 1245, 1250-52; Treas. Reg. §§ 1.1245-1 to -6 (1965). *See generally* Schapiro, *Recapture of Depreciation and Section 1245 of the Internal Revenue Code*, 72 YALE L.J. 1483, 1488-91 (1963).

[106] I.R.C. § 1245(a)(3).

[107] "The non-recognition provision . . . which section 1245 overrides [includes] . . . [section] . . . 311(a) . . . ." Treas. Reg. § 1.1245-6(b) (1965); *see* I.R.C. § 1245(d).

provisions applying to real estate in section 1250 and to farm property in sections 1251 and 1252 will result in similar treatment.[108]

For an example of this recapture under section 1245, assume a corporation plans to distribute an automobile to its sole shareholder as a dividend in-kind. The adjusted basis of the automobile is $500 and its fair market value is $1,000. Upon distribution, the corporation will be required to recapture any depreciation it has taken up to the difference in the automobile's adjusted basis and its fair market value. Assuming the corporation purchased the car for $5,000, it would have to recapture $500, which will be taxed as ordinary gain to the corporation. It is thus evident that the recapture provisions limit the tax advantages a corporation may enjoy in distributing section 1245 property since, in many instances, the appreciation above adjusted basis is less than the amount recaptured. Therefore, the corporation must recognize as much gain when the property is distributed in-kind as it would have recognized if the property had been sold outright. This is one reason investment securities are so popular as property dividends.

2. Distributions of Property in Payment of a Cash Dividend Debt

When a dividend is declared, it is usually framed in terms of cash. This declaration creates a corporate debt,[109] the cash payment of which would not create a gain, just as payment of any general debt in cash would cause no gain.[110] If the dividend debt is paid with appreciated property, however, an argument can be made that the payment is a taxable disposition in which the corporation must recognize any gain.[111] Several cases antedating the 1954 Code held that a corporation should recognize a gain when it distributes appreciated property to satisfy a dividend debt.[112] The present status of these cases, however, is unclear since even though a shareholder is considered a creditor of the corpora-

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[108] *See* I.R.C. §§ 1250 to -52; Treas. Reg. §§ 1.1250-1 to -5 (1971); Treas. Reg. §§ 1.1251-1 to -4 (1976); *id.* §§ 1.1252-1 to -2.

[109] The corporate law aspects of the creation of a dividend debt are discussed in notes 9 through 12 and accompanying text *supra*.

[110] It is a basic proposition of tax law that payment of debts with cash creates no gain to the debtor since the adjusted basis of cash always equals its fair market value. *See* I.R.C. §§ 1001, 1002.

[111] *Cf.* Davis v. United States, 370 U.S. 65 (1962), *noted in* 42 NEB. L. REV. 857 (1962). In *Davis*, the taxpayer had paid an alimony settlement with appreciated stock. The Supreme Court, after ruling the payment was for a legal debt, stated that he must recognize any gain he realized on the transfer. 370 U.S. at 67-68.

[112] *See* Smith Bros. Ref. Co., 5 T.C.M. (CCH) 17, 19 (1946); Brown-McMillan Veneer Co., 14 B.T.A. 556, 559-60 (1930); *cf.* Callanan Road Improvement Co., 12 B.T.A. 1109 (1928) (court allowed corporation to recognize loss incurred in distributing depreciated property in satisfaction of a dividend debt).

tion upon the declaration of a dividend, the distribution of the property arguably is "with respect to stock" from which no gain is recognized.[113] Nevertheless, these cases may maintain their viability on the ground "that it is not the distribution, but the satisfaction of the debt, that produces the gain or loss."[114] Obviously, if the corporation never paid dividend debts with appreciated property, the issue would never arise. Moreover, any time appreciated property is to be used as the means of distributing dividends, the dividend resolution can be drafted in terms of the property. The distribution would then fall within the section 311 non-recognition provision. Additionally, if the property has depreciated in value below its adjusted basis, a prudent corporation should sell the property, recognize a loss and distribute the proceeds to its shareholders.

3. Non-Statutory Exceptions

Beyond the statutory exceptions to the recognition of gain, two judicially created theories have evolved which should be considered if a corporation is to successfully avoid a tax on the appreciation of the property distributed in-kind. First, the corporation must take care that it has not effectively made an assignment of income[115] to its shareholders from previous earnings. Second, the corporation must avoid the appearance of a quick sale of the property from which an imputation of gain[116] to the corporation could be made.

a. Assignment of Income

When Congress drafted section 311, the Senate Report stated that the section was not intended to change the existing law relating to assignments of income[117] as reflected in the case of *Commissioner v. First State Bank.*[118] *In First State*, a bank had written off a number of promissory notes as bad debts. Later, however, the bank detailed one

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[113] *See* I.R.C. § 311(a); Treas. Reg. § 1.311-1(a) (1955); Mintz & Plumb, *supra* note 99, at 54.

[114] *See* B. BITTKER & J. EUSTICE, *supra* note 1, at 7-42.

[115] *See* Treas. Reg. § 1.311-1(a) (1955); B. BITTKER & J. EUSTICE, *supra* note 1, at 7-43; Lyon & Eustice, *Assignment of Income: Fruit and Tree as Irrigated by the P.G. Lake Case*, 17 TAX. L. REV. 295, 296-301 (1962); Comment, *The Imputed Sale and Anticipatory Assignment of Income Doctrines: Their Effects on I.R.C. §§ 311 and 336*, 15 BUFFALO L. REV. 154, 164-65 (1965).

[116] Imputation of gain is a recognition by the corporation of income computed as the difference in the sale price and the adjusted basis from the sale of an asset previously distributed to a shareholder as a dividend. See section II. *A.* 3. *b. infra.*

[117] S. REP. No. 1622, 83d Cong., 2d Sess. 247 (1954).

[118] 168 F.2d 1004 (5th Cir.), *cert. denied*, 335 U.S. 867 (1948), *noted in* 20 MISS. L.J. 391 (1949); *accord*, Commissioner v. State Bank, 172 F.2d 224, 224 (5th Cir. 1949).

of its officers to collect whatever notes he could and subsequently transferred the proceeds of fruitful collection efforts to its stockholders.[119] In holding that the collected amounts were taxable to the bank, the court seemingly relied upon two theories to support its decision. The first was a "tax benefit" analysis under which the court reasoned that if the bank received the benefit of the write off, it must also recognize the accompanying gain.[120] Also employed was an anticipatory assignment theory of the type referred to by the Senate. The court stated that the existence of an anticipatory assignment of income "depends upon the nature of the property distributed in relation to the capital structure of the corporation."[121] Under this analysis, the notes were no longer a part of the bank's capital structure, but instead simply potential income. By using the proceeds of the notes as dividends, the bank had negotiated an assignment of its right to receive the income.[122]

Thus, simply stated, an anticipatory assignment of income is an attempt by the taxpayer to assign the right to receive income due from another and thereby avoid the tax on its receipt.[123] This, of course, conflicts with the tax revenue laws whose function it is to tax the "income [of] those who earn or otherwise create the right to receive it and enjoy the benefit when paid."[124] The distribution of accounts receivable as a dividend is a most obvious example of this type of assignment.[125]

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[119] 168 F.2d at 1005.

[120] *Id.* at 1006-07.

[121] *Id.* at 1007.

[122] *Id.* at 1008.

[123] For example, if a taxpayer owned a bearer bond and gave the interest coupon to a third party, the taxpayer would be required to recognize the gain. This result is based upon the rationale that gain must be reported by the party earning the right to such gain. On the other hand, if the taxpayer presented the entire bond with coupons to a third party, the third party would be responsible for the gain. The "fruit and tree" concept, as it is commonly known, simply states that the fruit (gain) will not be attributed to a tree (bond) other than that from whence it grew. Thus, the party who enjoys the fruit realizes earnings and does not escape taxation. Helvering v. Horst, 311 U.S. 112, 120 (1940). Likewise, declaration by a corporation of a dividend in-kind in appreciated property, prior to a sale of the property, would cause no taxable consequence since the unrealized earnings had been distributed. The corporation would realize earnings with the resultant tax liability only if the property had been sold. *Id.*

[124] *Id.* at 119; *accord*, Harrison v. Schaffner, 312 U.S. 579, 580-82 (1941) (assignments of trust income to third parties by the life beneficiary held to be an anticipatory assignment of income); Helvering v. Eubank, 311 U.S. 122, 124-25 (1940) (renewal commissions of insurance agent paid to assignee characterized as an assignment of income); Lucas v. Earl, 281 U.S. 111, 113 (1930) (husband's assignment of salary to wife taxable to husband).

[125] *See* Cummins Diesel Sales of Colo. Co. v. United States, 263 F. Supp. 667, 683-84 (D. Colo. 1967); Williamson v. United States, 292 F.2d 524, 529 (Ct. Cl. 1961).

b. Imputation of Gain at Sale

When appreciated assets are distributed, the individual shareholders take the assets with an adjusted basis equal to the fair market value of such assets.[126] If they sell the assets immediately upon receipt, no further gain is imputed to them. Consider, however, the corporation which negotiates the sale of the assets, but to avoid the additional tax, distributes them to the shareholders for ultimate sale. Must the corporation recognize any gain resulting from the sale by the shareholders? In the 1945 case of *Commissioner v. Court Holding Co.*,[127] the United States Supreme Court answered this question in the affirmative.

In *Court Holding*, a closely held corporation had, following preliminary negotiations, entered into an oral agreement to sell its sole asset, a building. Prior to consummating the sale, the corporation's attorney advised the corporation's shareholders of the double-tax consequences the upcoming sale would have upon the anticipated liquidation of the corporation. Thus, to avoid this double tax, the corporation distributed the building to the shareholders, who concluded the sale as prearranged.[128] Basing its decision upon the determination that, in fact, the corporation had perfected the sale,[129] the Court ruled that the gain would be imputed to the corporation and, therefore, was taxable to the corporation.[130]

Because the decision in *Court Holding* was based upon the corporation actually "making the sale" and the stockholders acting as mere conduits, the decision's vitality was not affected by the enactment of section 311 and its subsequent application to property distributions. Thus, in a similar context, the *Court Holding* rationale seemingly would be binding today.[131] Subsequently, however, the Court took the opportunity to further explain its position on imputation of income.

In *United States v. Cumberland Public Service Co.*,[132] the share-

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[126] This provision is based upon the assumption that the earnings and profits, either current or accumulative, are greater than the fair market value of the assets. The individual shareholders would recognize a dividend gain on the distribution. I.R.C. § 301(c). If the earnings and profits do not exceed the fair market value, the amount in excess of the earnings and profits initially reduces the shareholders' basis in their stock, I.R.C. § 301(c)(2), and then, if the basis is reduced to zero, is treated as capital gain, I.R.C. § 301(c)(3). For a more extensive discussion of shareholder gain and earnings, and profits, *see* B. BITTKER & J. EUSTICE, *supra* note 1, at ¶¶ 7.03, -.04.

[127] 324 U.S. 331 (1945).

[128] *Id.* at 333.

[129] *Id.*

[130] *Id.* at 334.

[131] *See* Waltham Netoco Theatres, Inc. v. Commissioner, 49 T.C. 399, 404-05, *aff'd*, 401 F.2d 333 (1st Cir. 1968); Comment, *supra* note 115, at 156-63. *See also* Ripy Bros. Distillers, Inc. v. Commissioner, 11 T.C. 326 (1948).

[132] 338 U.S. 451 (1950).

holders of a closely held corporation attempted to sell their stock to another corporation. Although their initial offer was rejected, the buyer countered with an offer to purchase certain of the corporation's assets. The corporation rejected the counter-offer, but distributed the assets to its shareholders as a dividend. After independent negotiations with the same buyer, the shareholders sold the property. Later, the Internal Revenue Service levied a deficiency tax against the corporation for the gain realized from the sale.[133] In contrast with *Court Holding*, the Court in *Cumberland* recognized that "the sale was made by the stockholders rather than the corporation."[134] Consequently, no imputation of gain could be made to the corporation since the sale had been arranged and consummated by the shareholders in their individual capacities.[135]

The *Court Holding* doctrine was further expanded in *United States v. Lynch*.[136] In *Lynch*, the corporation had distributed inventory to its shareholders. Although the normal marketing facilities of the corporation were used to dispose of the property on behalf of the shareholders, no negotiations for the sale of the property had taken place prior to distribution.[137] Noting the lack of commercial purpose, the United States Court of Appeals for the Ninth Circuit ruled that the distribution of inventory coupled with the use of the corporation as a selling agent required imputation of gain to the corporation.[138] The court continued to say that the situation in *Lynch* was closely akin to the distribution of profits under the anticipatory assignment of income theory.[139]

The Tax Court took the final step in 1964 with its decision in *A.B.C.D. Lands, Inc. v. Commissioner*.[140] The court ruled that income from the sale of appreciated property distributed as a dividend should be imputed to the corporation even in the absence of corporate participation in the sale if, in effect, the corporation had made the sale.[141] Since

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[133] *Id.* at 452-53.

[134] *Id.* at 455.

[135] *Id.* at 455-56.

[136] 192 F.2d 718 (9th Cir. 1951), *cert. denied*, 343 U.S. 934 (1952).

[137] 192 F.2d at 719-20.

[138] *Id.* at 720. The court relied heavily upon Commissioner v. Transport Trading & Terminal Corp., 176 F.2d 570 (2d Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). In *Transport Trading*, the corporation had distributed stock to its sole shareholder immediately before a sale. The court found an adequate basis for imputing gain to the corporation because the corporation had participated in negotiations for the sale prior to the distribution. 176 F.2d at 572. The court, however, did indicate that a contrary result would possibly have been reached if the corporation had not participated in the negotiations. *Id.*

[139] 192 F.2d at 721; *see* Helvering v. Eubanks, 311 U.S. 122, 124-25 (1940); Helvering v. Horst, 311 U.S. 112, 118-20 (1940).

[140] 41 T.C. 840 (1964).

[141] *Id.* at 847.

the inventory of the corporation had annually been distributed to the shareholders for immediate sale,[142] the theory of *A.B.C.D. Lands* seems to be that an imputation of income will be made whenever a distribution of property is made for a non-tax purpose with an immediate sale expected.

The United States Court of Appeals for the Fifth Circuit, however, has rejected the Internal Revenue Service position articulated in *A.B.C.D. Lands*. In *Hines v. United States*,[143] land was distributed by the corporation after it had received several offers to purchase the same land. The resulting sale by the shareholders, however, was in no way controlled by these offers.[144] The government argued that the

> imputed income rule must apply even in the absence of pre-distribution sales negotiations, if the transfer was made (1) by an ongoing concern (2) in anticipation of a sale by the shareholders, and (3) with no valid business purpose aside from motives of tax avoidance.[145]

Rejecting this argument, the court construed *Court Holding* and *Cumberland* to require an imputation of gain "[o]nly if the corporation in fact participated in the sale transaction, by negotiations, prior agreement, post-distribution activities or *participated* in any other significant manner."[146] Excepting the Tax Court's decision in *A.B.C.D. Lands*, which was criticized for its logic and not its effect,[147] the court found no judicial precedent to support the government's argument and chose not to further expand the already elasticized theory.[148]

The *Court Holding-Cumberland* dichotomy and its subsequent judicial constructions could cause problems for corporations if distributions are made with an expectation of sale. Nevertheless, there are steps which can be taken by the distributing corporation to help avoid such problems: (1) distribute non-inventory property; (2) do not participate in any negotiations for sale either before or after distribution; and (3) advise the shareholders to hold the property a reasonable time to avoid the appearance of an anticipated quick sale.

B. Effect of a Distribution In-Kind on Earnings and Profits

Section 312 of the 1954 Code provides the statutory rules governing

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[142] *Id.* at 851.
[143] 477 F.2d 1063 (5th Cir. 1973), *rev'g* 344 F. Supp. 1259 (N.D. Miss. 1972).
[144] 477 F.2d at 1071.
[145] *Id.* at 1069.
[146] *Id.* at 1069-70.
[147] *Id.* at 1071.
[148] *Id.*

the effect distributions will have on earnings and profits.[149] The general rule is set forth in section 312(a) with two special exceptions provided in parts (b) and (c). The general rule provides that upon a distribution of property, a corporation's earnings and profits are reduced by the sum of: "(1) the amount of money, (2) the principle amount of the obligations of such corporation, and (3) the adjusted basis of the other property, so distributed."[150] Since section 311 stipulates that a corporation does not recognize a gain or loss on a distribution in-kind,[151] and since section 312(b) makes special adjustments for certain inventory distributions,[152] it appears that the provisions of section 312 are intended to be exhaustive as to earnings and profits. Accordingly, a distribution of property results in a decrease in earnings and profits equal to the adjusted basis of such property. The fact that the property appreciated in value causes no further adjustment.[153] Furthermore, there seems to be no correlation between the distribution's effect upon the earnings and profits and any taxability to the shareholders.[154]

An exception to the general rule is provided in section 312(b) for cases in which "inventory assets"[155] with an adjusted basis less than fair

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[149] *See* I.R.C. § 312. The term "earnings and profits" is not defined by the Internal Revenue Code of 1954. Basically, it encompasses the net income of the corporation after certain adjustments have been made. Some deductions may be taken from earnings and profits that cannot be deducted in computing taxable income, *e.g.*, dividend distributions, federal income taxes and expenses incurred in earning the tax-exempt income. Several additions to earnings and profits are also available, *e.g.*, dividends from other corporations, carryover or carryback losses that were deducted from taxable income, and capital loss carryback. The "earnings and profits" computation is of vital importance since this account determines whether distributions to shareholders will be viewed as dividend income or as a return of capital. *See* B. BITTKER & J. EUSTICE, *supra* note 1, at ¶ 7.03; 1 J. MERTENS, LAW OF FEDERAL INCOME TAXATION §§ 9.28 to -.36 (rev. ed. 1974); *cf.* Rev. Pro. 75-17, 1975-1 C.B. 677 (discusses the mechanics of computing earnings and profits). *See generally* Rudick, *"Dividends" and "Earnings or Profits" Under the Income Tax Law: Corporate Non-Liquidating Distribution*, 89 U. PA. L. REV. 865 (1941).

[150] I.R.C. § 312(a).

[151] *Id.* § 311. *But see* notes 100 through 108 and accompanying text *supra* (exceptions to the general rule of section 311).

[152] I.R.C. § 312(b); *see* Treas. Reg. § 1.312-2 (1955).

[153] S. REP. No. 1622, 83d Cong., 2d Sess. 248 (1954); *see* H. H. Robertson Co. v. Commissioner, 59 T.C. 53, 70-73 (1972).

[154] The tax to individual shareholders is based upon the fair market value of the property as it relates to the total amount of earnings and profits. Any effect on earnings and profits is determined by the adjusted basis of the distributed property. Commissioner v. Godley's Estate, 213 F.2d 529, 533 (3d Cir.), *cert. denied*, 348 U.S. 862 (1954); *accord*, Commissioner v. Hirshon Trust, 213 F.2d 523, 527 (2d Cir.), *cert. denied*, 348 U.S. 861 (1954).

[155] "Inventory assets" include stock in trade, property held primarily for sale by customers in the ordinary course of business, and unrealized fees and receivables from the sale or exchange of other inventory assets. I.R.C. § 312(b)(2).

market value are distributed to shareholders. Earnings and profits are increased by the amount of the excess, which would represent the extent of appreciation in value over the adjusted basis.[156] At the same time, earnings and profits are decreased by the fair market value of the distributed inventory assets or by the lesser of the earnings and profits as increased by the appreciation.[157]

The exception in section 312(c) requires that any decrease in earning and profits caused by a distribution be reduced by "the amount of any liability to which the property distributed is subject . . . [and] the amount of any liability of the corporation assumed by a shareholder in connection with the distribution."[158] Additionally, it should be noted that a corporation recognizes a gain under section 311(c) if the assumed liability exceeds the basis in the hands of the distributing corporation.[159] The gain would increase the earnings and profits accordingly after adjustment for tax was made.[160]

C. *The Tax Effects of a "Write Up" of Appreciated Assets*

Historically, American income tax laws have been founded upon the premise that "a *growth* or *increment* of value *in* the investment," without a sale or exchange, is not taxable as income.[161] Therefore, any appreciation of an asset imposes no tax consequences upon a corporation before a sale or exchange of the asset. A write up is merely an accounting adjustment of the corporate accounts designed to increase the asset's book value to its true value. Since there has been no taxable sale or

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[156] *Id.* § 312(b)(1)(A); *see* Treas. Reg. § 1.312-2 (1955); B. BITTKER & J. EUSTICE, *supra* note 1, at 7-55.

[157] I.R.C. § 312(b)(1)(B).

[158] I.R.C. § 312(c); *see* Treas. Reg. § 1.312-3 (1955).

[159] See note 101 and accompanying text *supra*.

[160] *See* Treas. Reg. § 1.312-4, Example 2 (1955); B. BITTKER & J. EUSTICE, *supra* note 1, at 7-57. An adjustment to earnings and profits is not necessary for any gain recognized by the corporation on the distribution of property which is not specified in section 312(c)(3). *See* Rev. Rul. 74-337, 1974-2 C.B. 94 (recognizing gain from transfer of installment obligation).

Other upward adjustments to earnings and profits are required by section 312(c) as a result of gains realized by the corporation under the sections 1245 and 1250 depreciation recapture provisions, the section 341(f) collapsible property provision, and the sections 1251 and 1252 farming recapture provisions. I.R.C. § 312(c)(3).

[161] Eisner v. Macomber, 252 U.S. 189, 207 (1920). In *Eisner*, the corporation declared a stock dividend, which the IRS chose to tax. The Supreme Court rejected the IRS's argument and held that the transaction was merely a reshuffling of assets on the balance sheet and did not result in any taxable income. Income was described by the Court as the gain derived from capital, labor or from a combination of the two, including profit gained through sale or conversion of capital and excluding appreciation. *Id.*; *see* United States v. Carter, 19 F.2d 121, 122 (5th Cir. 1927); Trust Co. v. Rose, 25 F.2d 997, 998-99 (N.D. Ga.), *aff'd*, 28 F.2d 767 (5th Cir. 1928).

exchange, a write up also has no tax consequences.[162] Likewise, since the computation of a corporation's earnings and profits is derived from taxable income,[163] and since a write up causes no increase in the taxable income of the corporation, the corporate earnings and profits will not be increased.[164]

Additionally, a tax advantage will result if the corporation had little or no earnings and profits before the asset is written up. Dividends declared from the written-up surplus pool, after depleting any earnings and profits account, will be treated as a return of capital rather than as ordinary income.[165] This tax treatment does not avoid appreciation going into the earnings and profits account, however, since when the asset is sold and gain is recognized, the earnings and profits account will be adjusted upward accordingly.[166] Instead, writing up assets adds flexibility to management's decision as to when dividends may be distributed, when gain is to be recognized, and the consequences of each.

III. Analysis and Conclusion

This Comment has reviewed the corporate and tax consequences that the appreciation attributable to an increase in the value of a corporation's assets can have upon the declaration and payment of dividends. The goal, however, is not mere awareness of these consequences, but instead the revision of existing corporate dividend policies. Consequently, in this section, each of the three methods of distributing appreciated property will be evaluated in light of the previous general discussions of their mechanics.

A. Sale of an Appreciated Asset

Obviously, a corporation may sell an appreciated asset and distribute the gain in the form of a cash dividend. Indeed, the source of the earned surplus from which the dividend would be declared is the gain recognized from the sale of the asset. Tax consequences, however, militate against utilization of this alternative since the corporation would be taxed to the full extent of the gain—a result most corporations would

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[162] *See* General Util. & Operating Co. v. Helvering, 296 U.S. 200, 205-06 (1935); District of Columbia v. Oppenheimer, 301 F.2d 563, 564 (D.C. Cir. 1962).

[163] See note 149 *supra*.

[164] *See* Commissioner v. Gross, 236 F.2d 612, 616-17 (2d Cir. 1956); Commissioner v. Godley's Estate, 213 F.2d 529, 532 (3d Cir.), *cert. denied*, 348 U.S. 862 (1954); Commissioner v. Hershon Trust, 213 F.2d 523, 527 (2d Cir.), *cert. denied*, 348 U.S. 861 (1954); Andrews, *"Out of Its Earnings and Profits": Some Reflections on the Taxation of Dividends*, 69 Harv. L. Rev. 1403, 1430-32 (1956).

[165] See note 51 *supra*.

[166] *See* Commissioner v. Gross, 236 F.2d 612, 617 (2d Cir. 1956).

choose to avoid. Furthermore, in the situation where the property represents part of the corporation's working assets, vital to the continuation of its operations, such a sale of the property would impair the corporation's normal business activities and perhaps its very existence. As a practical matter, only investment-type assets should be the subject of this option.

In sum, the sale of an appreciated asset followed by a cash distribution of the gain is the most secure alternative only in the sense that the end result is clearly predictable. From a purely financial standpoint, however, this alternative is the least advantageous given the goal of distributing the most dividends at a minimum cost to the corporation.

B. A Dividend In-Kind

The second option available to the corporation is to distribute the asset as a dividend in-kind. This form of distribution can effectively place more value in the hands of the shareholders than the corporation has in its earned surplus account.[167] Nevertheless, it should be noted that to the extent the value of the dividend exceeds the earned surplus account, no more gain is created under this option than would have been obtained from a sale of the asset.[168]

As a general rule, however, an in-kind distribution will escape any taxation of the appreciation. Yet, in differing degrees depending upon the types of property, even this benefit has been limited either through the statutory exceptions to the general rule or through the judicially created doctrines of anticipatory assignment of income or imputation of gain.[169] Thus, investment-type assets such as stocks, bonds or land, which are usually unaffected by these exceptions, are generally the most easily amenable to in-kind distribution.

In terms of working assets, a dividend in-kind is beset with the same practical problems of business operations impairment encountered when a corporation simply sells the asset and distributes the proceeds. Moreover, because the recapture provisions of the Internal Revenue Code apply to working assets, a gain must be recognized which may obviate any other tax advantages.[170] Again, unless investment assets alone are distributed, the exceptions swallow up the general rule of favorable tax treatment.

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[167] See notes 28 through 30 and accompanying text *supra*.

[168] See notes 31 through 33 and accompanying text *supra*.

[169] See sections II. *A*. 1. and II. *A*. 3. *supra*.

[170] See notes 105 through 108 and accompanying text *supra*.

C. *"Writing Up" Assets*

The final alternative available to corporate management allows an appreciated asset to be written up to its fair market value and the difference between that value and the asset's book value to be distributed to shareholders as a dividend. The writing up of appreciated assets is not expressly prohibited by the Mississippi Business Corporation Act.[171] Moreover, several commentators have urged that, in statutes worded precisely the same as Mississippi's, a write up should be permitted, and an additionally favorable view has been indicated by the Mississippi Supreme Court.[172] It is thus reasonable to conclude that the court in any later decision would not withdraw its recognition of the business practicalities of asset appreciation.

Assuming that a corporation has the inherent authority under Mississippi law to revalue assets, the allocation of the newly created surplus is the next obstacle to be overcome. This impediment, however, should fall before the arguments that appreciation is actually gain or income and that appreciation should simply be viewed as "reverse depreciation."[173] Under these theories, any allocation of appreciation should be placed in the earned surplus account. Additionally, the uncertainty that the capital surplus account has in relation to its use as a dividend source militates in favor of an allocation to earned surplus.

Valuation is the final obstacle. Since rarely would any two methods of valuation arrive at the same market value, selection of the proper method is significant.[174] A generally reliable valuation is frequently found when there is a readily available market, as with blue-chip stocks on a national exchange, at least in relation to an asset with a stable price. Unfortunately, this is the exceptional situation. When considering valuation in situations where fair market value is difficult to determine, management should adopt a conservative valuation to avoid possible impairment of capital and any concomitant personal liability.

Equally important, in terms of dividend policies, is the fact that the writing up of assets offers many advantages to a corporation whose working assets have appreciated in value. Following revaluation, a corporation can distribute a dividend without a sale of the assets. Thus, the shareholders have received a gain on their investment without purposefully hampering the corporation's ability to continue its operations. An additional benefit can be obtained in the situation where the

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[171] See note 71 and accompanying text *supra*.

[172] Scott Bldg. Supply Corp. v. Mississippi State Tax Comm'n, 235 Miss. 22, 36-37, 108 So. 2d 557, 563-64 (1959). See notes 72 through 76 and accompanying text *supra*.

[173] See notes 77 through 81 and accompanying text *supra*.

[174] See notes 84 & 85 and accompanying text *supra*.

corporation has little or no earnings and profits since a cash distribution from an appreciated asset is taxed under the more favorable return-of-capital provisions. Also, either a sale or a dividend in-kind of the assets would cause ordinary taxable income to the corporation through a recapture of depreciation. This expense is completely avoided by a write up since it has no tax consequence to the corporation.[175]

The advantages of revaluation end, however, when the intended dividend is appreciated property which has been held for investment. Because the corporation would not be taxed under either the revaluation approach or the in-kind approach,[176] and because the shareholders would be taxed the same regardless of the method employed,[177] no advantage is obtained by revaluation. Moreover, to prevent recognition of future gain from appreciated investment assets, the corporation must still distribute an in-kind dividend, but, in order to affect such a dividend, its earned surplus account must be at least equal to the recently written up asset.[178]

T. Franklin Myers, Jr.

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[175] See notes 161 through 166 and accompanying text *supra*.

[176] See notes 90 through 93 and accompanying text *supra*.

[177] *See* I.R.C. § 301(c)(1).

[178] See section I. *A*. *supra*.

RECENT DECISIONS

TITLE VII—RETROACTIVE SENIORITY—SECTION 703(h) DOES NOT BAR DISTRICT COURT ORDER OF RETROACTIVE SENIORITY RELIEF TO REINSTATE DISCRIMINATEES TO "RIGHTFUL PLACE"

Harold Franks and Johnnie Lee[1] brought a class action against their employer, the Bowman Transportation Company,[2] alleging various racially discriminatory employment practices[3] which violated Title VII of the Civil Rights Act of 1964.[4] The complaint requested both declaratory and equitable relief.[5] Franks had been employed by Bowman in its tire shop. After several unsuccessful attempts to transfer into a better paying department, Franks filed a charge with the Equal Employment Opportunity Commission (EEOC)[6] contending that the company promoted racially discriminatory hiring practices.[7] Immediately after an EEOC investigation of the charge, Franks was discharged by Bowman for unauthorized use of company vehicles.[8] Lee, who had also filed a charge with the EEOC, alleged that he had been refused employment as a truck

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[1] The original suit was filed by Franks. Lee intervened as plaintiff to press his individual claim and those of other employees and applicants against the company. Franks v. Bowman Transp. Co., 424 U.S. 747, 750-51 (1976).

[2] The Bowman Transportation Company is an interstate trucking firm operating as a common carrier throughout the southeastern region of the United States and portions of the midwest. The company is licensed by the Interstate Commerce Commission. Franks v. Bowman Transp. Co., 495 F.2d 398, 402-03 (5th Cir. 1974), *rev'd*, 424 U.S. 747 (1976). In addition to Bowman, the United Steel Workers of America, AFL-CIO, was named as a defendant. The complaint alleged that the union's collective bargaining agreement with the company fostered racially discriminatory employment practices. 424 U.S. at 750.

[3] Franks alleged discrimination in the company's refusal to promote him and in his discharge following an EEOC investigation precipitated by his complaints. Lee alleged that Bowman discriminated against blacks in its hiring practices and that he too had been fired because of his race. 495 F.2d at 402-03.

[4] Civil Rights Act of 1964, Title VII, 42 U.S.C. §§ 2000e to -15 (1970), *as amended by* 42 U.S.C. §§ 2000e to -17 (Supp. III 1973).

[5] Franks sought an injunction against the company's discriminatory no-transfer policy (city driving to over-the-road driving), reinstatement as a Bowman employee and recovery of wages he would have earned had the company promoted him under a nondiscriminatory employment system. Lee's complaint also sought reinstatement and back pay. More important, however, was Lee's request that he and other members of the class be granted seniority retroactive to the date they were refused employment. 424 U.S. at 750-51.

[6] The EEOC is a federal agency created to administer Title VII. *See* 42 U.S.C. § 2000e-4 (1970). *See generally* Note, *Title VII, Seniority Discrimination, and the Incumbent Negro*, 80 HARV. L. REV. 1260, 1260-62 (1967).

[7] Franks charged that Bowman refused to promote him because of a company policy of employing blacks only in the tire shop. The complaint was not filed until Franks saw white employees hired in the departments into which he had attempted to transfer. 495 F.2d at 403.

[8] The district court found that Franks had been discharged because of his race. *Id.*

driver because of his race.[9] The district court permanently enjoined Bowman from continuing existing discriminatory practices and ordered the company to notify all class members of their respective rights.[10] The district court, however, refused to grant back pay or retroactive seniority[11] as a remedy. On appeal to the United States Court of Appeals for the Fifth Circuit, Franks and Lee excepted to the district court's refusal to order retroactive seniority contending that such relief was within the equitable power of a federal court.[12] Bowman maintained that an award of seniority relief would adversely affect the economic interests of its other employees[13] and was, as a matter of law, prohibited by Title VII.[14] The court of appeals accepted Bowman's argument and affirmed the dis-

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[9] In response to these charges, Lee was hired as one of Bowman's first over-the-road drivers. Although Lee was subsequently discharged, the district court found no racial discrimination in the company's action. *Id.* at 406-09.

[10] *Id.* at 402.

[11] A "seniority system" is broadly defined as a set of rules governing job movements such as promotion, transfer, downgrading and layoffs. Employees with the longest service are given the greatest job security and the best opportunities for advancement. Seniority may be measured by length of service in the plant, in a specific department, in a "line of progression" or even in a particular job. Retroactive or "fictional" seniority is given for time not actually worked. There are two types of retroactive or fictional seniority. The first, "competitive status" seniority, applies when the granting of a benefit to one employee necessitates its denial to some or all other employees. Examples of "competitive status" seniority range from the employee's right to keep his job while someone else is laid off, to an employee's right to a preferred place in the punch-out line. The second, "benefit" seniority, refers to the use of an employee's earned seniority credits in computing his level of economic "fringe" benefits. Examples of "benefit" seniority include such noncompetitive entitlements as pension benefits and vacation time increments. 424 U.S. at 782-91.

While courts have used the terms retroactive seniority and fictional seniority to denote the same thing, a distinct difference exists between the two. Fictional seniority is given for the time the employee was prevented from working because of the employer's distrimination. *See* Local 189, Papermakers & Paperworkers v. United States, 416 F.2d 980, 994-95 (5th Cir. 1969), *cert. denied*, 397 U.S. 919 (1970). Retroactive seniority refers not only to time not worked, but also to the time from the date of employment until the discrimination ceases. *See generally* S. SLICHTER, J. HEALY & E. LIVERNASH, THE IMPACT OF COLLECTIVE BARGAINING ON MANAGEMENT 106 (1960); Cooper & Sobol, *Seniority and Testing Under Fair Employment Laws: A General Approach to Objective Criteria of Hiring and Promotion*, 82 HARV. L. REV. 1598, 1601-02 (1969); Stacy, *Title VII Seniority Remedies in a Time of Economic Downturn*, 28 VAND. L. REV. 489 (1975); Comment, *Reflections On The Legal Nature and Enforceability of Seniority Rights*, 75 HARV. L. REV. 1532 (1961).

[12] Appellants contended that sections 703(h) and 706(g) of Title VII vest the district courts with broad powers to fashion equitable remedies for Title VII violations. Such remedies were included in order to "make whole" the discriminatee and to correct the effects of past discrimination. Thus, under appellant's theory, the district court's denial of retroactive seniority served to undermine the intent of Title VII and constituted only partial relief. 495 F.2d at 414.

[13] 424 U.S. at 772-75. Bowman did not question the district court's finding that discrimination did in fact exist under the company's current employment practices. 495 F.2d at 415.

[14] Bowman relied upon the discretionary authority given the district courts by section

trict court's denial of seniority relief.[15] On writ of certiorari the United States Supreme Court, *held*, reversed. Section 703(h) of Title VII of the Civil Rights Act of 1964 does not bar retroactive "benefit" or "competitive status" seniority relief, and section 706(g) of Title VII authorizes a federal court to order such affirmative relief as deemed appropriate to reinstate the affected discriminatees to their "rightful place." *Franks v. Bowman Transportation Co.*, 424 U.S. 747 (1976).

The concept of awarding retroactive seniority to victims of racially discriminatory employment practices was spawned by the enactment of the National Labor Relations Act of 1935.[16] It was not until the adoption of the sweeping provisions of Title VII of the Civil Rights Act of 1964,[17] however, that the concept began to develop fully.[18] The idea of retroactive seniority evolved because minority employees often lacked seniority as a result of prior discrimination in hiring practices and were thus subject to discharge and layoff under a "last hired, first fired" system.[19] Consequently, the broad provisions of Title VII offered some hope for relief to minority workers confronted with this problem.

The first systems to come under attack dealt with the operation of departmental,[20] job[21] and line-of-progression[22] seniority. Under these systems, seniority

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706(g) to weigh the competing equities arising in each case and thereby to determine the appropriateness of a particular remedy. To award retroactive seniority in this particular case would work an injustice on the company's white employees which far outweighed what little remedial action seniority relief might accomplish. 424 U.S. at 780-83.

[15] 495 F.2d at 417. In affirming the district court, the court relied upon section 703(h) of Title VII, 42 U.S.C. § 2000e-2(h) (Supp. III 1973), which provides, *inter alia*, that it shall not be an unlawful employment practice for an employer to apply different conditions of employment pursuant to a "bona fide" seniority system. In addition, the court of appeals (1) reversed the district court's denial of back pay to unnamed members of the class; (2) vacated so much of the district court's decree as denied the request for additional affirmative relief; and (3) remanded to update the trial record and to consider the necessity of additional affirmative relief. *Id.* at 419-23.

[16] 29 U.S.C. §§ 151 *et seq.* (1970). *See also* notes 59 & 60 and accompanying text *infra*.

[17] *See* note 4 *supra*.

[18] As employment practices, seniority systems became a matter of federal concern with the enactment of Title VII. The Supreme Court, in Alexander v. Gardner-Denver Co., 415 U.S. 35 (1974), stated that "Title VII's strictures are absolute and represent a congressional command that each employee be free from discriminatory practices." *Id.* at 51.

[19] *See* Edwards & Zaretsky, *Preferential Remedies for Employment Discrimination*, 74 MICH. L. REV. 1, 40-41 (1975). *See generally* Comment, *Last Hired, First Fired Seniority, Layoffs, and Title VII: Questions of Liability and Remedy*, 11 COLUM. J. L. & SOC. PROB. 343, 376, 378 (1975).

[20] *E.g.*, Pettway v. American Cast Iron Pipe Co., 494 F.2d 211, 217 (5th Cir. 1974) (company's operations organized into various departments); Head v. Timken Roller Bearing Co., 486 F.2d 870, 873 (6th Cir. 1973) (after 1968 change to plant-wide system, plaintiffs charged that the entire pre-1968 departmental seniority transfer system was discriminatory); Robinson v. Lorillard Corp., 444 F.2d 791, 794 (4th Cir.), *cert. denied*, 404 U.S. 1006 (1971) (five departments were all white and blacks occupied the four lowest paying departments); Irvin v. Mohawk Rubber Co., 308 F. Supp. 152, 154 (E.D. Ark. 1970) (departments divided into six divisions and approximately 90% of all blacks worked in lower paying, menial departments).

is measured by the length of time an employee works in a particular department, job or line.[23] Upon transfer or promotion to another position, the employee loses the seniority accumulated in the previous position and must reaccumulate seniority in the new department.[24] In effect, these seniority systems not only restrain the promotion and transfer of minorities previously denied such opportunities because of discrimination, but also subject minority workers to layoffs as a result of their lack of seniority.[25] To remedy this situation, the courts have required that seniority be measured by the total time worked in the plant (employment seniority)[26] or by the total time the discriminatee was qualified for a position in the restricted department.[27] Consequently, remedies for minority workers who were hired but later suffered discriminatory delay in achieving promotions or transfers are well settled.[28]

Unfortunately, minority applicants denied employment at an earlier date because of race or sex, but subsequently hired when the employer ceased its discriminatory hiring practices,[29] have been forced to seek relief within a much

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[21] *E.g.*, United States v. Jacksonville Terminal Co., 451 F.2d 418, 424 (5th Cir.), *cert. denied*, 406 U.S. 906 (1972) (active employees occupied 102 separate job categories); Local 189, Papermakers & Paperworkers v. United States, 416 F.2d 980, 983 (5th Cir. 1969), *cert. denied*, 397 U.S. 919 (1970) (promotion determined by "job seniority").

[22] *E.g.*, United States v. Georgia Power Co., 474 F.2d 906, 926 (5th Cir. 1973) (seniority systems which limited minority advancements and rendered minorities more susceptible to layoffs converted into plant seniority systems); United States v. Hayes Int'l Corp., 456 F.2d 112, 115 (5th Cir. 1972) (blacks placed in separate lines of progression and seniority divisions within production and maintenance unit); United States v. H. K. Porter Co., 296 F. Supp. 40, 54 (N.D. Ala. 1968) (majority of jobs arranged in lines of progression by which employees advanced from entry job through progression line to highest rated jobs within department).

[23] Note, *The Problem of Last Hired, First Fired: Retroactive Seniority As A Remedy Under Title VII*, 9 GA. L. REV. 661, 612 (1975).

[24] *Id.*

[25] *Id.*; *see* Note, *supra* note 6. *See also* Note, *Title VII and Work Force Reductions: Jersey Central Power & Light Co. v. Local Union 327, Etc. of I.B.E.W.*, 8 CONN. L. REV. 159 (1975).

[26] *E.g.*, Johnson v Goodyear Tire & Rubber Co., 491 F.2d 1364, 1374 (5th Cir. 1974); United States v. Roadway Express, Inc., 457 F.2d 854, 856 (6th Cir. 1972); Irvin v. Mohawk Rubber Co., 308 F. Supp. 152, 161 (E.D. Ark. 1970); Quarles v. Philip Morris, Inc., 279 F. Supp. 505, 521 (E.D. Va. 1968).

[27] *E.g.*, United States v. T.I.M.E.-D.C., Inc., 517 F.2d 299, 320 (5th Cir. 1975); Herrera v. Yellow Freight Sys., Inc., 505 F.2d 66, 68 (5th Cir. 1974); Rodriguez v. East Texas Motor Freight, 505 F.2d 40, 63 (5th Cir. 1974).

[28] Johnson v. Goodyear Tire & Rubber Co., 491 F.2d 1364, 1373 (5th Cir. 1974) (court changed job seniority to plant or employment seniority); United States v. Jacksonville Terminal Co., 451 F.2d 418, 460 (5th Cir. 1971), *cert. denied*, 406 U.S. 906 (1972) (plant seniority to be used in place of departmental seniority); *cf.* Thornton v. East Texas Motor Freight, 497 F.2d 416, 419 (6th Cir. 1974) (seniority computed from date employee qualified for advancement rather than date of employment); Bing v. Roadway Express, Inc., 444 F.2d 687, 691 (5th Cir. 1971) (seniority rights granted from time employees possessed experience necessary for road job).

[29] *See, e.g.*, Meadows v. Ford Motor Co., 510 F.2d 939, 940 (6th Cir. 1975) (company refused to hire applicant because of sex); Jurinko v. Edwin L. Wiegand Co., 477 F.2d 1038,

less settled body of law. This state of affairs has persisted even though these workers are more susceptible to layoffs and stand to derive greater benefits from seniority than employees refused transfer or promotion.[30] When a facially neutral plant seniority system has been found to perpetuate the effects of prior racial discrimination, the courts have: (1) held that the plant (employment) seniority system is a "bona fide" system under section 703(h) and is thus beyond the reach of Title VII;[31] (2) held that the system is in violation of Title VII since it perpetuates the effects of prior discrimination;[32] or (3) modified the system by granting retroactive seniority to the affected minorities.[33]

The first approach, holding that the system is beyond the scope of Title VII, was announced by the Fifth Circuit in *Local 189, Papermakers & Paperworkers v. United States.*[34] In *Papermakers,* the court modified a job seniority system by granting retroactive seniority to the time of employment but noted in dictum that sections 703(h)[35] and 703(j)[36] prohibit judicial modification of an employ-

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1040 (3d Cir.), *vacated and remanded on other grounds,* 414 U.S. 970 (1973); Schaefer v. Tannian, 394 F. Supp. 1136, 1137 (E.D. Mich. 1975) (female discriminatee laid off under last hired, first fired seniority system).

[30] *See* Meadows v. Ford Motor Co., 510 F.2d 939, 940 (6th Cir. 1975); Morrow v. Crisler, 479 F.2d 960, 962 (5th Cir. 1973), *cert. denied,* 419 U.S. 895 (1974).

[31] Watkins v. United Steel Workers Local 2369, 516 F.2d 41, 52 (5th Cir. 1975); Jersey Cent. Power & Light Co. v. Local 327, IBEW, 508 F.2d 687, 706-07 (3d Cir. 1975), *noted in* 8 CONN. L. REV. 159 (1975); Waters v. Wisconsin Steel Works of Int'l Harvester Co., 502 F.2d 1309, 1318 (7th Cir. 1974). In *Watkins,* the court found that none of the employees had sought employment before 1965, the effective date of Title VII, and that the company had not discriminated since that time. The court, however, stated that

> [e]ven if one could arrive at a determination that the seniority system was somehow discriminatory, we think it would be exempted from being an unlawful employment practice under Title VII by Section 703(h) . . . .

516 F.2d at 46.

[32] *E.g.,* Watkins v. United Steel Workers Local 2369, 369 F. Supp. 1221, 1231 (E.D. La. 1974), *rev'd,* 516 F.2d 41 (5th Cir. 1975).

[33] *E.g.,* Meadows v. Ford Motor Co., 510 F.2d 939, 949 (6th Cir. 1975); *accord,* Jurinko v. Edwin L. Wiegand Co., 477 F.2d 1038, 1046-47 (3d Cir.), *vacated and remanded on other grounds,* 414 U.S. 970 (1973); *see* Allen v. City of Mobile, 331 F. Supp. 1134, 1150-51 (S.D. Ala. 1971).

[34] 416 F.2d 980 (5th Cir. 1969), *cert. denied,* 397 U.S. 919 (1970), *noted in* 74 MICH. L. REV. 41-43 (1975); *accord* Quarles v. Philip Morris, Inc., 279 F. Supp. 505 (E.D. Va. 1968), *noted in* 46 N.C.L. REV. 891 (1968).

[35] U.S.C. § 2000e-2(h) (1970) provides in pertinent part:

> Notwithstanding any other provision of this subchapter, it shall not be an unlawful employment practice for an employer to apply different standards of compensation, or different terms, conditions, or privileges of employment pursuant to a bona fide seniority or merit system . . . provided that such differences are not the result of an intention to discriminate because of race, color, religion, sex, or national origin . . . .

The problem facing the courts is whether a facially neutral seniority system violates Title VII when it perpetuates past discrimination. *E.g.,* Griggs v. Duke Power Co., 401 U.S. 424, 429-30 (1971); Palmer v. General Mills, Inc., 513 F.2d 1040, 1042-43 (6th Cir. 1975). If the court finds that the seniority system violates Title VII, the system still may be beyond the scope of Title VII if the employer can prove "business necessity." *See* Albemarle Paper

ment seniority system.[37] To hold otherwise would create "fictional" seniority for newly hired blacks which, the court reasoned, constituted preferential rather than remedial treatment.[38] The *Papermakers* dictum was subsequently followed by the Seventh Circuit in *Waters v. Wisconsin Steel Works of International Harvester Co.*[39] The *Waters* court refused to alter an employment seniority system which perpetuated the effects of past racial discrimination, holding that such preferential treatment of one group of employees would violate section 703(j).[40] Noting that section 703(h) prohibits judicial interference with a "bona fide" seniority system,[41] the court reasoned that the legislative history of Title VII, as evidenced by the Clark memoranda,[42] demonstrated a Congressional

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Co. v. Moody, 422 U.S. 405, 425 (1975); Head v. Timken Roller Bearing Co., 486 F.2d 870, 877 (6th Cir. 1973). The test is whether an overriding legitimate business purpose exists. To satisfy the test, the practice must be: (1) necessary to the safe and efficient operation of the business; (2) sufficiently compelling to override any racial impact; and (3) effectively carrying out the business purpose it is alleged to serve. In addition, there must be available no acceptable alternative policies or practices which would better accomplish the business purpose advanced or accomplish it equally well with a lesser differential racial impact. *Id.* at 879. *See also* Robinson v. Lorillard, 444 F.2d 791, 796-97 (4th Cir. 1971).

[36] 42 U.S.C. § 2000e-2(j) (1970) provides:

> Nothing contained in this subchapter shall be interpreted to require any employer, employment agency, labor organization, or joint labor-management committee subject to this subchapter to grant preferential treatment to any individual or to any group because of the race, color, religion, sex, or national origin of such individual or group on account of an imbalance which may exist with respect to the total number or percentage of persons of any race, color, religion, sex, or national origin employed by any employer referred or classified for employment by any employment agency or labor organization, admitted to membership or employed in, any apprenticeship or other training program, in comparison with the total number or percentage of persons of such race, color, religion, sex, or national origin in any community, state, section, or other area, or in the available work force in any community, state, section, or other area.

[37] 416 F.2d at 995.

[38] *Id.*

[39] 502 F.2d 1309, 1317-19 (7th Cir. 1974); *accord* Watkins v. United Steel Workers Local 2369, 516 F.2d 41, 46-47 (5th Cir. 1975); *cf.* Evans v. United Air Lines, Inc., 534 F.2d 1247 (7th Cir. 1976). The court in *Evans* distinguished *Waters* on the fact that the employees in *Waters* failed to establish a causal connection between the inferior seniority status which resulted in their layoffs and specific acts of personal discrimination. *Id.* at 1249. Further, the discriminatory practices in *Waters* occurred prior to the passage of Title VII. *Id.*

[40] 502 F.2d at 1309, 1317-20; *accord,* Quarles v. Philip Morris, Inc., 279 F. Supp. 505, 516-18 (E.D. Va. 1968). *Contra,* Meadows v. Ford Motor Co., 510 F.2d 939, 949 (6th Cir. 1975).

[41] 502 F.2d at 1317-19; *cf.* Johnson v. Goodyear Tire & Rubber Co., 491 F.2d 1364, 1373 (5th Cir. 1974) (seniority system effectively locked into labor department blacks who were segregated on racial basis); Irvin v. Mohawk Rubber Co., 308 F. Supp. 152, 160-61 (E.D. Ark. 1970) (present consequences of pre-Title VII discrimination are covered by Act).

[42] The Clark memoranda are a set of questions and answers prepared by Senators Clark of Pennsylvania and Case of New Jersey in the defense and explanation of Title VII

refusal to "[shackle] white employees with a burden of past discrimination created not by them but by their employer."[43] In like fashion, the Third Circuit, in *Jersey Central Power & Light Co. v. Local 327, IBEW*,[44] held that layoffs in reverse order of seniority pursuant to a racially neutral plant-wide seniority system did not violate Title VII even though such layoffs had a disparate impact upon minority employees as a result of past discrimination.[45] The court observed that if a remedy is needed to eliminate the effects of past discrimination, the Congress should enact it.[46]

A second approach was submitted in *Watkins v. United Steel Workers Local 2369*.[47] The court in *Watkins* rejected the nonintervention approach to facially neutral employment seniority systems which perpetuate the effects of past discrimination and found a remedy by totally invalidating the system. Although section 703(h) prohibits the courts from interfering with a "bona fide" seniority system, the court reasoned that a system which perpetuated the effects of past discrimination could not be "bona fide" and was thus invalid.[48] In effect, the court decided that any detriment to nonminority incumbent workers may be overridden by the need to extinguish the effects of past discrimination.

The most recent approach taken by the courts has been the granting of retroactive seniority.[49] In rejecting the nonintervention and invalidation approaches,[50] these courts have necessarily rejected the *Papermakers* dictum[51] and the interpretation of the Clark memoranda set forth in *Waters*.[52] Instead, great reliance has been placed upon the reasoning of the United States Supreme Court in *Griggs v. Duke Power Co.*[53] In *Griggs*, the Court observed that the primary objective of Title VII was to achieve equality in employment opportunities and remove barriers which have operated to favor white employees over minority employees.[54] The Court also noted that, under Title VII, facially neutral proce-

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before Congress. During the course of the congressional debates, it was stated that: "Title VII would have no effect on *established* seniority rights. Its effect is prospective and not retrospective." 110 Cong. Rec. 7213 (1964) (emphasis added). *See also* United States v. H.K. Porter Co., 296 F. Supp. 40 (N.D. Ala. 1968); Vaas, *Title VII: Legislative History*, 7 B & C Ind. & Comm. L. Rev. 431, 445 (1966).

[43] 502 F.2d at 1320.

[44] 508 F.2d 687 (3d Cir. 1975), *vacated and remanded*, 96 S. Ct. 2196 (1976).

[45] 508 F.2d at 706.

[46] *Id.* at 710; *accord*, United States v. Jacksonville Terminal Co., 451 F.2d 418, 445-46 (5th Cir. 1971).

[47] 369 F. Supp. 1221 (E.D. La. 1974), *rev'd on other grounds*, 516 F.2d 41 (5th Cir. 1975).

[48] 369 F. Supp. at 1227-29.

[49] *See* note 33 *supra*.

[50] *See* notes 31 & 32 and accompanying text *supra*.

[51] *See* notes 34 through 39 and accompanying text *supra*. *See also* Meadows v. Ford Motor Co., 510 F.2d 939, 949 (6th Cir. 1975); Schaefer v. Tannian, 394 F. Supp. 1136, 1145-49 (E.D. Mich. 1975); Delay v. Carling Brewing, 9 Empl. Prac. Dec. 6643, 6644 (N.D. Ga. 1974); Loy v. City of Cleveland, 8 F.E.P. Cases 615, 616-17 (N.D. Ohio 1974).

[52] *See* note 42 and accompanying text *supra*.

[53] 401 U.S. 424 (1971).

[54] *Id.* at 429-30.

dures or tests cannot be permitted if they operate to lock in the effects of prior discriminatory employment practices.[55] Beyond their reliance upon *Griggs*, such courts have held that in order to implement the "make whole"[56] provisions of Title VII and restore discriminatees to their "rightful place,"[57] section 706(g)[58] must be interpreted as vesting appropriate equitable powers in the federal district courts. Yet another basis for awarding retroactive seniority was promulgated in *Albermarle Paper Co. v. Moody.*[59] *Albermarle* explained that since the remedial provisons of Title VII were fashioned after the remedial provisions of the National Labor Relations Act,[60] such provisions should be construed in a manner consistent with the cases decided under that Act. Since retroactive seniority relief is a common remedy for victims of unfair labor practices,[61] such a remedy could also be drawn from Title VII.[62]

Unlike the development in labor law, retroactive seniority, as a remedy for

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[55] *Id.*

[56] There is a general consensus that a federal district court possesses broad discretionary power under section 706(g) to fashion a remedy to achieve the "make whole" objective of Title VII. *Compare* Albermarle Paper Co. v. Moody, 422 U.S. 405, 421 (1974), Rosen v. Public Serv. Elec. & Gas Co., 477 F.2d 90, 96 (3d Cir. 1973), United States v. Georgia Power Co., 474 F.2d 906, 926-27 (5th Cir. 1973), United States v. Roadway Express, Inc., 457 F.2d 854, 856 (6th Cir. 1972) *and* Vogler v. McCarty, Inc., 451 F.2d 1236, 1238 (5th Cir. 1971) *with* Morrow v. Crisler, 479 F.2d 960, 963-65 (5th Cir. 1973), LeBlanc v. Southern Bell Tel. & Tel. Co., 460 F.2d 1228, 1229 (5th Cir. 1972) *and* United States v. Hayes Int'l Co., 415 F.2d 1038, 1044-45 (5th Cir. 1969).

[57] "Rightful place," as a remedial theory under Title VII, requires putting the discriminatee in the same position he would have occupied but for the wrongful discrimination practiced against him. Thornton v. East Texas Motor Freight, 497 F.2d 416, 419 (6th Cir. 1974); *see* United States v. T.I.M.E.-D.C., Inc., 517 F.2d 299, 317 (5th Cir. 1975). There are two other alternative remedies available to a court when a seniority system is found to be discriminatory. Under the "status quo" approach, the positions achieved by white incumbents would remain unchanged. Under the "freedom now" approach, the discriminatees would immediately assume the jobs they would have had if there had been no discrimination, thus displacing the white incumbent employees. *See* Note, *supra* note 6, at 1268. The "rightful place" approach has been widely accepted as the best method for remedying past discrimination in the area of seniority. *E.g.*, Local 189, United Papermakers & Paperworkers v. United States, 416 F.2d 980, 988 (5th Cir. 1969), *cert. denied*, 397 U.S. 919 (1970).

[58] 42 U.S.C. § 2000e-5(g) (1972) provides:

> If the court finds that the respondent has intentionally engaged in or is intentionally engaging in an unlawful employment practice charged in the complaint, the court may enjoin the respondent from engaging in such unlawful employment practice, and order such affirmative action as may be appropriate, which may include, but is not limited to, reinstatement or hiring of employees, with or without back pay (payable by the employer, employment agency, or labor organization, as the case may be, responsible for the unlawful employment practice), or any other equitable relief as the court deems appropriate. . . .

[59] 422 U.S. 405 (1975).

[60] *Id.* at 419-21, *citing* 110 Cong. Rec. 6549 (1964).

[61] *See* Aclang, Inc., 78 L.R.R.M. 1204, 1208 (1971); Bob's Casing Crews, 71 L.R.R.M. 1582, 1584 (1969). *See also* NLRB v. Lone Star Textiles, Inc., 386 F.2d 535, 537 (5th Cir. 1967).

[62] 422 U.S. at 419-21.

employment discrimination, was not widely used immediately after the enactment of the Civil Rights Act of 1964. One reason for this retarded development was the failure of Title VII claimants to request such relief. This reluctance seems particularly odd since the reasoning of several courts leads to the conclusion that retroactive seniority was readily available in some courts at an early date.[63] The retroactive seniority remedy was given a belated prod in *Jurinko v. Edwin L. Wiegand Co.*,[64] where the Third Circuit awarded two married women seniority and back pay dating from the time employment was denied to the date they were actually hired.[65] In 1974, four federal district court cases followed the lead of the *Jurinko* court and held that retroactive seniority was an appropriate remedy under Title VII regardless of the effect on innocent incumbent employees.[66] The most recent decision to award retroactive seniority came in *Meadows v. Ford Motor Co.*[67] In *Meadows* the Sixth Circuit awarded retroactive seniority noting, however, that the positions of both the affected minority class and the nonminority class should be considered before an automatic award of such relief is given.[68]

In the instant case, the majority reasoned that since one of the main purposes of Title VII is to put the affected minority class in their rightful place, and since there is no indication in the legislative history of Title VII which would lead the Court to modify or restrict relief otherwise appropriate, section 703(h) of Title VII does not bar retroactive seniority relief once a facially neutral seniority system is found to perpetuate the effects of prior discrimination.[69] The Court then concluded that since the object of Title VII is to make the victim "whole" for injuries suffered on account of unlawful employment discrimination, and since retroactive seniority relief is ordinarily necessary to achieve this

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[63] *See generally* Louisiana v. United States, 380 U.S. 145, 154 (1965); Bowie v. Colgate-Palmolive Co., 416 F.2d 711, 721 (7th Cir. 1969); Harper v. Mayor & City Council, 359 F. Supp. 1187, 1211-18 (D. Md.), *modified and aff'd sub nom.*, Harper v. Kloster, 486 F.2d 1134 (4th Cir. 1973).

[64] 477 F.2d 1038 (3d Cir.), *vacated and remanded on other grounds*, 414 U.S. 970 (1973).

[65] 477 F.2d at 1046 (employment denied the two women because of their marital status).

[66] Schaefer v. Tannian, 394 F. Supp. 1136, 1148-49 (E.D. Mich. 1975) (burden of retroactive seniority on incumbent white worker does not bar such relief); Watkins v. United Steel Workers Local 2369, 369 F. Supp 1221, 1232 (E.D. La. 1974), *rev'd*, 516 F.2d 41 (5th Cir. 1975) (seniority advantages of incumbent whites are not indefeasibly vested rights); Delay v. Carling Brewing, 9 Empl. Prac. Dec. 6643, 6644 (N.D. Ga. 1974) (affirmative action required to eliminate the effects of past discrimination); Loy v. City of Cleveland, 8 F.E.P. Cases 615, 616 (N.D. Ohio 1974) (seniority system should not benefit nondiscriminatees).

[67] 510 F.2d 939 (6th Cir. 1975).

[68] *Id.* at 949. The court instructed that because the impact of interference with the seniority system on incumbent employees would be more severe than a remedy of back pay, a higher standard of proof of injury would be required before a remedy of retroactive seniority is given. *Id.*; *cf.* Local 189, Papermakers & Paperworkers v. United States, 416 F.2d 980, 988 (5th Cir. 1969), *cert. denied*, 397 U.S. 919 (1970) (court applied *Meadows* rationale to fictional seniority). *See also* Jurinko v. Edwin L. Wiegand Co., 477 F.2d 1038, 1046 (3d Cir.), *vacated and remanded on other grounds*, 414 U.S. 970 (1973).

[69] Franks v. Bowman Transp. Co., 424 U.S. 747, 758-62 (1976).

objective, section 706(g) of Title VII vests broad equitable discretion in the federal courts to order such affirmative action as may be appropriate to place the victim in his rightful place, notwithstanding the fact that the awarding of these remedies may conflict with the economic interests of other nonminority employees.[70]

In dissent, Justice Powell[71] noted that since section 706(g) of Title VII gives the district courts a broad range of discretionary power in awarding retroactive seniority relief, the courts should consider not only the claims of the discrimination victim, but also the economic impact on the innocent incumbent employees.[72]

Chief Justice Burger, in a concise dissent, objected to the fact that "competitive status" seniority relief could be given at the expense of innocent incumbent employees.[73] The Chief Justice further concluded that a monetary award or "front pay" to the victim would provide a more equitable remedy.[74]

In *Franks*, the Supreme Court attempted to settle a problem which has plagued the federal courts since the adoption of Title VII. Specifically, the courts have been unable to determine when remedial action crosses over into preferential treatment and, if it does, whether Title VII protection can be extended so as to fundamentally alter the economic expectations of innocent incumbent workers. This problem concerns not only the federal courts, but also the employers, unions and employees who must work within the parameters of Title VII.[75] The majority has made its position clear: Title VII bars neither preferential treatment nor a remedy that would adversely affect the economic expectations of innocent incumbent employees when there is a need to eradicate the effects of prior discrimination in employment practices.[76] In effect, this holding reverses the widely accepted *Papermakers* dictum. Those courts which heretofore have been reluctant to grant retroactive seniority have now received a green light to do so.[77]

Of greater importance, however, are the problems created by the *Franks* decision. Like many so-called reforms, an award of retroactive seniority exhibits great appeal in brief and oral argument. Unfortunately, much of this appeal is lost when the award is displaced from the courtroom into the offices and factories which ultimately must pay its price. In practical effect, an award of retroactive "competitive status" seniority does not punish only the employer for dis-

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[70] *Id.* at 762-79.

[71] Mr. Justice Powell was joined in his dissent by Mr. Justice Rehnquist.

[72] 424 U.S. at 795-99 (Powell, J., dissenting). Mr. Justice Powell also stated that the courts should distinguish between the treatment accorded "benefit" and "competitive status" seniority. *Id.* at 788-91; *see* note 11 *supra*.

[73] 424 U.S. at 780 (Burger, C. J., dissenting). The Chief Justice did, however, concede that retroactive "benefit" seniority relief could sometimes be appropriate and equitable.

[74] *Id. See generally* Edwards & Zaretsky, *supra* note 19.

[75] *See* Note, *supra* note 23, at 657.

[76] 424 U.S. at 757-80.

[77] Although *Franks* does not introduce any new principles to the law of employment discrimination, it does bolster the holding of the Sixth Circuit in *Meadows* by providing a basic framework for subsequent courts to follow.

criminatory employment practices. Instead, such remedies place an economic hardship on the innocent incumbent employees as well. Thus, the decision to award such remedies should depend in part upon the degree of adversity inflicted upon nonminority workers. The federal courts should use their broad discretionary powers to initially consider the effects upon the respective parties and weigh the equities before deciding to employ the retroactive seniority remedy. These facts of economic life were at the core of Chief Justice Burger's and Justice Powell's dissents in *Franks*.[78] A more workable and equitable solution to the problem could have been achieved by either adopting the balancing process conceived in *Meadows*[79] or, where the employer is financially able to bear the cost, awarding monetary benefits to the victims.[80] These remedies would place a greater portion of the remedial burden upon the delinquent employer rather than the innocent incumbent employee.

Still another problem to be confronted in the aftermath of *Franks* is the probability that ingenious counsel, armed with the majority's opinion and an irresistable plaintiff, will persuade a sympathetic forum to award retroactive seniority to the victims of an employer's discriminatory employment practices *and* monetary damages to the incumbent employees as compensation for their losses. The calculation of such damages in itself presents a formidable task to the courts. More importantly, such awards would place employers and unions in a precarious if not impossible position. Trapped between demands to remedy past discrimination on the one hand, and to compensate incumbent employees for damages caused to their job security due to a cure for racial discrimination that was not their fault on the other, the employer could be forced to seek contribution from the consumer in the form of increased prices.[81]

Thus, in the final analysis, the Supreme Court's attempt in *Franks* to formulate a uniform policy under which employers, unions and employees would be aware of the impact of Title VII upon the work environment has succeeded only in tendering yet another question for its decision—whether affirmative action programs designed to cure the effects of past discrimination can be squared with the increasingly important problem of reverse discrimination.

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[78] 424 U.S. at 786-88 (Powell, J., dissenting).

[79] *Id.* at 793-94.

[80] *See id.* at 780 (Burger, C. J., dissenting). In two recent cases, the courts have followed the dissenters' view that while affirmative action by the courts may be appropriate in certain instances, the economic expectations of innocent incumbent employees must also be considered. In American Tel. & Tel. Co., 416 F. Supp. 435 (1976), Judge Gehard Gesell held that employees who lose promotions (economic benefits) because of court-ordered affirmative action programs may be entitled to compensation for their losses. *Id.* at 440. Similarly, in McDonald v. Santa Fe Trail Transp. Co., 96 S. Ct. 2574 (1976), the Court held that both black and white employees are protected from discrimination by employers and unions. *Id.* at 2578.

[81] Upon closer scrutiny, however, this argument may prove too much. In any case, it is not dispositive of the issue since, in a broad sense, the society as well as the individual employer has perpetuated the discrimination which has necessitated the instant solution. Consequently, it is not unconscionable to require both to pay. *See generally* Note, *Last Hired, First Fired Layoffs*, 88 HARV. L. REV. 1544, 1553-60 (1975).

PROPERTY—TENANCY BY THE ENTIRETY—EFFECT OF DIVORCE ON TENANCY BY THE ENTIRETY IN MISSISSIPPI

Following the death of his ex-wife, defendant filed a motion pursuant to an earlier divorce decree[1] for a final adjudication of property rights in a tract of land owned during their marriage. The property in question had been conveyed to defendant and his ex-wife "as an estate in entirety, with the right of survivorship, and not as tenants in common."[2] Defendant contended that by virtue of the right of survivorship he was the sole owner of the property. In response, the executrix of the wife's estate argued that the divorce terminated the estate in the entirety thereby creating a tenancy in common. Under this theory, a one-half interest in the land vested in the deceased's estate.[3] The chancery court rejected the executrix's argument and held that after the divorce the parties held the property "as joint tenants as an estate in the entirety with the right of survivorship."[4] Accordingly, defendant was granted sole ownership of the property.[5] On appeal to the Mississippi Supreme Court, *held,* affirmed. A tenancy by the entirety is a joint tenancy with rights of survivorship plus a marital relation, and upon dissolution of the marriage the parties remain joint tenants with the right of survivorship. *Shepard v. Shepard,* 336 So. 2d 497 (Miss. 1976).

The early common law favored joint tenancies[6] for two reasons. First, their use allowed estates to be maintained unbroken.[7] Second, joint tenancies facili-

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[1] The divorce decree, granted to Fannie Shepard in May 1966, specifically provided that all property rights were taken under advisement by the chancellor. No further action was taken until defendant filed this motion for a final hearing in 1974. Shepard v. Shepard, 336 So. 2d 497, 498 (Miss. 1976).

[2] *Id.* at 498. The words of conveyance satisfied existing statutory requirements for the establishment of a tenancy by the entirety. *See* MISS. CODE ANN. § 89-1-7 (1972), which provides:

> All conveyances or devises of land made to two or more persons, including conveyances or devises to husband and wife, shall be construed to create estates in common and not in joint tenancy or entirety, unless it manifestly appears from the tenor of the instrument that it was intended to create an estate in joint tenancy or entirety with the right of survivorship. But an estate in joint tenancy or entirety with right of survivorship may be created by such conveyance from the owner or owners to himself, themselves and others or to himself, themselves and others.
>
> This section shall not apply to mortgages or devises or to conveyances made in trust.

[3] The executrix, joined by the devisees under the will of Fannie Shepard, included in the answer a cross-bill praying that the court hold that the property had vested one-half in defendant and one-half in the devisees. 336 So. 2d at 498.

[4] *Id.*

[5] *Id.*

[6] The particular type of joint estate was determined by the incidence of the four unities: time, title, possession and interest. An estate which included possession but lacked either time, title or interest was a tenancy in common. An estate which had all of the unities was a joint tenancy. An estate having all four unities and a marital relation was a tenancy by the entirety. 3 W. BLACKSTONE COMMENTARIES 180-86, 191-94 (G. Tucker ed. 1803).

[7] *E.g.*, Wolfe v. Wolfe, 207 Miss. 480, 488, 42 So. 2d 438, 438 (1949); 4 G. THOMPSON,

tated the performance of feudal duties by vesting property ownership in one person through operation of the right of survivorship.[8] The common law also recognized with approval a conveyance to husband and wife, which was presumed[9] to create a tenancy by the entirety.[10] This presumption was founded upon the common law fiction of the unity of husband and wife.[11] Since at common law conveyances to more than one person created joint tenancies, the ultimate result was to give the spousal tenancy special ownership rights differing from those associated with joint tenancies.[12] One such difference was that while joint tenants could unilaterally convey their separate interests,[13] tenants by the entirety could not.[14] Thus, while a creditor had access to the full share of a joint tenant,[15] a tenancy by the entirety could be subjected only to the satisfaction of debts incurred jointly.[16] A tenancy by the entirety could, however, be de-

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COMMENTARIES ON THE MODERN LAW OF REAL PROPERTY § 1775, at 8 (repl. 1961); Note, *Joint Tenancies and Tenancies by the Entirety*, 36 KY. L.J. 202, 207 (1948); 2 CUM.-SAM. L. REV. 241, 242 (1971).

[8] 2 CUM.-SAM. L. REV. 241, 242 (1971).

[9] As late as 1967, a conveyance to husband and wife created a presumption in Massachusetts that the property was held as tenants by the entirety. Glendon, *Tenancies by the Entirety in Massachusetts*, 59 MASS. L.Q. 53, 54 & n.6 (1974). *See also* Bird v. Stein, 102 F. Supp. 399, 404 (S.D. Miss. 1952), *rev'd on other grounds*, 204 F.2d 122 (5th Cir. 1953). Tenancies by the entirety were litigated as early as 1291. 26 CORNELL L.Q. 507 n.1 (1941), *citing* Case of Margery de Mose, 1 Rolls in Parl. 66, 19 Edw. I (1291).

[10] An estate by the entirety may be held only by husband and wife, *e.g.*, Welborn v. Henry, 252 So. 2d 779, 779 (Miss. 1971), as a marital relation is a requirement for the creation of the estate. *See* note 6 *supra*.

[11] *See, e.g.*, Kepner, *The Effect of An Attempted Creation of An Estate By the Entirety in Unmarried Grantees*, 6 RUT. L. REV. 550, 552 (1951).

[12] [I]f an estate in fee be given to a man and his wife, they are neither properly joint-tenants, nor tenants in common: for husband and wife being considered as one person in law, they cannot take the estate by moieties, but both are seised of the entirety, *per tout et non per my;* the consequence of which is, that neither the husband nor the wife can dispose of any part without the assent of the other, but the whole must remain to the survivor.

3 W. BLACKSTONE, *supra* note 6, at 181. *See also, e.g.*, Sale v. Saunders, 24 Miss. 24, 35-36 (1852); 6 MO. L. REV. 207, 207 (1941).

[13] *See, e.g.*, O'Connor v. Dickerson, 188 So. 2d 241, 245 (Miss. 1966).

[14] *See, e.g.*, 3 W. BLACKSTONE, *supra* note 6, at 181, 184-86; Note, *supra* note 7, at 204. Under the common law view, the husband, by virtue of his control over the property, could alien his estate without the assent of the wife. The conveyance was, however, subject to defeat by the wife's survivorship. 6 MO. L. REV. 207, 207 (1941). See note 16 *infra*.

An important conceptual difference between joint tenancies and tenancies by the entirety was that the surviving joint tenants *succeeded* to the entire estate while a tenant by the entirety *continued* to hold the entire estate upon the death of the other spouse. Note, *supra* note 7, at 203. Thus, a tenancy by the entirety had no "right of survivorship." *See* W. BURBY, HANDBOOK OF THE LAW OF REAL PROPERTY § 95, at 227 (3d ed. 1965); 4 G. THOMPSON, *supra* note 7, § 1784, at 53-54.

[15] Phipps, *Tenancy by Entireties*, 25 TEMP. L.Q. 24, 38 (1951).

[16] See, *e.g.*, Kepner, *supra* note 11, at 552; 44 DICK. L. REV. 232, 233 (1940). Under common law, the usufruct of realty held by the entirety belonged solely to the husband during coverture, thereby enabling him to convey or mortgage the usufruct without the

stroyed either by mutual consent or divorce.[17]

The question of the effect of a divorce on a tenancy by the entirety did not arise at common law since *a vinculo matrimonii* was an annulment of the marriage *ab initio*.[18] The modern effect of a divorce, however, as it destroys a unity essential to the tenancy, is to create a distinct estate.[19] The estate so created, the tenancy in common,[20] is a consequence of modern judicial disfavor with joint tenancies.[21] In Mississippi, this disfavor is reflected in a series of enactments preceding the present statutory limitations on joint estates.[22] Initially, the Mississippi Supreme Court followed the strict common law principles in construing these statutes. For example, in *Hemingway v. Scales*,[23] the court considered the 1857 statute[24] and made it clear that both the statute and the common law concepts of tenancies would be strictly applied.[25] The language of the 1857

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assent of his wife. Kepner, *supra* note 11, at 552; *see* W. BURBY, *supra* note 14, at 225-26; 7 BROOKLYN L. REV. 256, 257 (1937); 15 N.Y.U.L. REV. Q. 138, 138 (1937).

[17] *See, e.g.*, BURBY, *supra* note 14, at 222.

[18] 14 MINN. L. REV. 562, 562 (1930); 78 U. PA. L. REV. 656, 657 n.8 (1930).

[19] See note 6 *supra*.

[20] *See, e.g.*, W. BURBY, *supra* note 14, at 227; W. POWELL, THE LAW OF REAL PROPERTY § 624, at 626 (abr. ed. 1968); 4 G. THOMPSON, *supra* note 7, § 1792, at 107; 14 MINN. L. REV. 562, 562-63 (1930); 13 MO. L. REV. 321, 323 (1948); 10 ORE. L. REV. 206, 206 (1931); 39 YALE L.J. 912, 912 (1930). This result also has been attained by statute. *See Arkansas*: ARK. STAT. ANN. § 34-1215 (Supp. 1975); *Michigan*: MICH. COMP. LAWS ANN. §§ 552.102, -.103 (1967); *Pennsylvania*: PA. STAT. ANN. tit. 68, § 501 (Purdon 1965).

[21] 39 YALE L.J. 912, 912 (1930); *see, e.g.*, Cross v. O'Cavanagh, 198 Miss. 137, 151, 21 So. 2d 473, 476 (1945). The dissipation of feudal duties probably constituted a major reason for the decline in importance of joint tenancies. *See, e.g.*, 4 G. THOMPSON, *supra* note 7, § 1782, at 35-36.

[22] *See* REV. MISS. CODE ch. 36, art. 18 (1857); REV. MISS. CODE § 2301 (1871); REV. MISS. CODE § 1197 (Campbell's 1880); ANN. MISS. CODE § 2441 (1892); ANN. MISS. CODE § 2770 (1906); ANN. MISS. CODE § 2274 (Hemingway's 1917); ANN. MISS. CODE § 2113 (1930); ANN. MISS. CODE § 834 (1942). The present statute is found at MISS. CODE ANN. § 89-1-7 (1972). See note 2 *supra*.

[23] 42 Miss. 1 (1868).

[24] REV. MISS. CODE ch. 36, art. 18 (1857).

> All conveyances or devises of lands, made to two or more persons, shall be construed to create estates in common, and not in joint tenancy, unless it shall manifestly appear from the tenor of the instrument, that it was intended to create an estate in joint tenancy, with the right to the survivor or survivors: *Provided*, this provision shall not apply to mortgagees, or devisees, on conveyances made in trust.

[25] The court stated that

> [o]ur statute is applicable to such estates only as were held in joint-tenancy at the common law, and was not intended to affect conveyances to husband and wife; for the reason that the estate created by such conveyance is not, in legal contemplation, an estate in joint-tenancy, and for the additional reason, that such conveyance to husband and wife is not, in a legal sense, a conveyance to two persons, but to those who, for this purpose, are accounted but one person in law.

42 Miss. at 18. The court reiterated this position in McDuff v. Beauchamp, 50 Miss. 531,

statute was amended by the 1880 Code to include conveyances to husband and wife.[26] The initial construction of the amended statute, *Conn v. Boutwell*,[27] involved a deed "to Pink Boutwell and wife." After citing *Hemingway* and *McDuff v. Beauchamp*[28] for the proposition that the prior statute affected only the right of survivorship of joint tenancies,[29] the court stated that the purpose of the amendment was to place a husband and wife in the same status as other persons with regard to conveyances or devises of land.[30]

Unfortunately, the court's position with respect to the distinctions between joint tenancies and tenancies by the entirety began to erode with its 1949 opinion in *Wolfe v. Wolfe*.[31] *Wolfe* involved two conveyances to husband and wife with both deeds containing words of survivorship.[32] The court stated that even though the statute[33] reversed the common law presumption favoring joint tenancies and tenancies by the entirety, it did not prohibit them.[34] Accordingly, the deeds in question contained language sufficient to defeat the statutory presump-

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535 (1874), Gresham v. King, 65 Miss. 387, 390, 4 So. 120, 121 (1888), and W. C. Ellis & Co. v. Walker, 101 Miss. 326, 331, 58 So. 97, 99 (1912).

[26] All conveyances or devises of lands, made to two or more persons, or to a husband and wife, shall be construed to create estates in common, and not in joint tenancy or entirety, unless it shall manifestly appear, from the tenor of the instrument, that it was intended to create an estate in joint tenancy, with the right to the survivor or survivors; *provided*, this provision shall not apply to mortgages or devises or conveyances made in trust.

REV. MISS. CODE § 1197 (Campbell's 1880). It should be noted that the statute did not specifically provide for the creation of tenancies by the entirety. It was this omission which began the blurring of the distinction between joint tenancies and tenancies by the entirety.

[27] 101 Miss. 353, 58 So. 105 (1912).

[28] 50 Miss. 531 (1874).

[29] 101 Miss. at 356-57, 58 So. at 106.

[30] *Id.*

[31] 207 Miss. 480, 42 So. 2d 438 (1949).

[32] The first conveyance was to husband and wife "and the survivor of them." The granting clause of the second deed read to husband and wife "and to the survivor of them." 207 Miss. at 487-88, 42 So. 2d at 438.

[33] ANN. MISS. CODE § 834 (1942), which read:

All conveyances or devises of land made to two or more persons, or to a husband and wife, shall be construed to create estates in common, and not in joint-tenancy or entirety, unless it manifestly appears from the tenor of the instrument, that it was intended to create an estate in joint-tenancy or entirety with the right of survivorship; but this provision shall not apply to mortgages or devises, or conveyances made in trust.

It is important to note a major grammatical distinction between this statute and the statute of 1880. *See* note 26 *supra*. By substituting for the words "an estate in joint tenancy, with the right to the survivor or survivors" in the 1880 Code the phrase "an estate in joint-tenancy or entirety with the right of survivorship" in the 1942 Code, the latter statute, while specifically allowing for the creation of an estate by the entireties, attributed a right of survivorship to the estate by the entirety. *Compare* REV. MISS. CODE § 1197 (Campbell's 1880) *with* ANN. MISS. CODE § 834 (1942). The significance of this change, first found in section 2441 of the 1892 Code, is that the right of survivorship is not an incident of a tenancy by the entirety. *See* note 14 *supra*.

[34] 207 Miss. at 489, 42 So. 2d at 439.

tion of an intent to create tenancies in common.[35] In reaching this decision, however, the court made two statements inconsistent with the common law incidents of tenancies by the entirety. First, after concluding that the deeds vested the right of survivorship in the grantees, the court stated that it would not determine whether the estate so created was a joint tenancy or a tenancy by the entirety.[36] The inconsistency here exists in the fact that a tenancy by the entirety has no right of survivorship.[37] Second, the court declared that the distinguishing and most important characteristic of a joint tenancy is its right of survivorship and that the same is true of a tenancy by the entirety.[38] This analysis is, of course, contrary to common law principles since a tenancy by the entirety is neither characterized nor distinguished by a right of survivorship.[39] Instead, a tenancy by the entirety is characterized and distinguished by both the unity of husband and wife necessary to create the estate and its inseverability by a unilateral act of one tenant.[40] By equating the two estates, the court ignored the very common law principles it had espoused in *Hemingway*.[41] However, when the court next confronted a tenancy by the entirety, in *Cuevas v. Cuevas*,[42] its traditionally strong adherence to common law principles[43] reappeared. *Cuevas* involved the inalienability of an estate by the entirety.[44] Specifically, the plaintiff had brought suit to cancel a conveyance by the defendant, plaintiff's ex-husband, purporting to convey an undivided one-half interest in the property at a time when the plaintiff and defendant were husband and wife. In holding for the plaintiff, the court stated that an estate by the entirety had been created and that such an estate could not have been severed or destroyed by an act of one of the tenants.[45] Quoting *Hemingway*, the court added that

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[35] *Id.*

[36] 207 Miss. at 488, 42 So. 2d at 438.

[37] *See* note 14 *supra*. The court's inconsistent language may have been due to the inconsistent language of the statute itself. *See* note 33 *supra*. This possibility is made even more likely in view of the court's traditionally strict construction of the statute. *See* note 25 and accompanying text *supra*.

[38] 207 Miss. at 489, 42 So. 2d at 439.

[39] *See* note 14 *supra*.

[40] *See, e.g.*, THOMPSON, *supra* note 7, § 1784, at 53.

[41] In equating the two estates, the court cited 4 G. THOMPSON, COMMENTARIES ON THE MODERN LAW OF REAL PROPERTY §§ 1778, 1791, 1804 (perm. ed. 1924). It is to be noted that the cited authority stated that a tenancy by the entirety has a right of survivorship despite a previous statement that the survivor did not take by right of survivorship. *See* 4 G. THOMPSON, *supra* note 7, § 1784, at 53-54. *See also* W. BURBY, *supra* note 14 at 227; 4 G. THOMPSON, *supra* note 7, § 1784, at 20 (Supp. 1976).

[42] 191 So. 2d 843 (Miss. 1966).

[43] *See* note 25 and accompanying text *supra*.

[44] 191 So. 2d 843, 844 (contested deed conveyed property to husband and wife "as joint tenants in entirety and not as tenants in common, but to the survivor").

[45] *Id.* at 846. It should be noted that the divorce was granted in Georgia. The divorce decree also set aside the conveyance in question and awarded the property and a money allowance to the plaintiff as alimony. *Id.* at 845. This raises the possibility that in its discussion of entireties the Mississippi Supreme Court was simply attempting to give full faith and credit to the Georgia decree. *See id.* at 847.

Mississippi recognized the common law distinction between joint tenancies and tenancies by the entirety,[47] a substantial deviation from its earlier language in *Wolfe*.[48] The *Wolfe* language equating the tenancies reappeared, however, in *Welborn v. Henry*,[49] which involved a conveyance from a widower to himself and his niece[50] as "tenants by the entirety and not as tenants in common, with full right of survivorship."[51] In construing the deed to create a joint tenancy, the court quoted the *Wolfe* equation of a joint tenancy with a tenancy by the entirety.[52] The effect of the opinion was to raise again the question of whether the court was merely careless with its language[53] or had actually merged joint tenancies with tenancies by the entirety. Subsequently, with the court's opinion in *Miller v. Miller*,[54] merger became the apparent answer. In *Miller*, the conveyance was made to husband and wife as joint tenants with right of survivorship. After their divorce, the parties agreed to a sale of the property and a division of the proceeds. The sole question raised by these facts concerned the proportionate distribution of the proceeds. The husband claimed that since his personal contributions represented 80/91 of the purchase price, he was entitled to a greater share of the property.[55] The court, while acknowledging that the conveyance actually created a tenancy by the entirety, stated that the divorce had no effect upon the estate conveyed and that the parties were therefore entitled to equal shares as joint tenants.[56] By concluding that the divorce had no effect

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[46] 42 Miss. 1, 16 (1868).

[47] 191 So. 2d at 850.

[48] *See* notes 36 through 41 and accompanying text *supra*.

[49] 252 So. 2d 779 (Miss. 1971).

[50] This conveyance was made pursuant to ANN. MISS. CODE § 834 (Supp. 1972), which provided as follows:

> All conveyances or devises of land made to two or more persons, or to husband and wife, shall be construed to create estates in common and not in joint tenancy or entirety, unless it manifestly appears from the tenor of the instrument that it was intended to create an estate in joint tenancy or entirety with the right of survivorship; provided, however, that an estate in joint tenancy or entirety with right of survivorship may be created by such conveyance from the owner or owners to himself, themselves and/or others; but this section shall not apply to mortgages or devises or conveyances made in trust.

[51] 252 So. 2d at 780.

[52] *Id.* at 780-81. See note 38 and accompanying text *supra*.

[53] Both the staunch common law tradition of the court, see note 25 and accompanying text *supra*, and its opinion in *Cuevas*, see notes 42 through 46 and accompanying text *supra*, seem to negate the possibility that the court had used loose language in *Welborn*.

[54] 298 So. 2d 704 (Miss. 1974).

[55] *Id.* at 705.

[56] The court stated that

> while the conveyance to husband and wife perhaps more accurately might be said to have created in them an estate by the entirety, dissolution of the marriage did not have the effect of altering the character, extent or attributes of the estate conveyed, and upon divorce, it *remained* one in equal joint tenancy, with the right of survivorship, under the express terms of the instrument which created it.

Id. at 706 (emphasis added).

upon the tenancy by the entirety and asserting that the parties *remained* joint tenants, the court implied that it recognized no distinction between joint tenancies and tenancies by the entirety.[57] Therefore, at least as early as 1974, the Mississippi Supreme Court not only had declared that divorce created a joint tenancy from a tenancy by the entirety, but also had implied that it recognized no distinction between the two estates.[58]

In the instant decision, the court stated that since the dissolution of a marriage by divorce does not of itself affect either spouse's title to the property,[59] there was no merit to appellant's contention that the divorce terminated the tenancy by the entirety and that the parties thereafter held the property as tenants in common. The court further stated that since an "estate in entirety was a joint tenancy with the right of survivorship plus the marital relation,"[60] and since the dissolution of a marriage under the present statute does not destroy the joint tenancy, the parties were no longer tenants by the entirety but continued as joint tenants with the right of survivorship.[61] In addition, the court reasoned that since a joint tenancy can be terminated by contract or agreement of the joint tenants or by implication when the parties enter into a valid contract inconsistent with the continuance of the joint tenancy, there was no termination in the instant case without evidence that the parties intended the estate in entirety to be dissolved.[62] Consequently, the court rejected appellant's contention that the parties intended that the estate by entirety be terminated.

Viewed from the common law concept of tenancies, the court's stated rationale in the instant case is erroneous.[63] The two tenancies, though merged by the court, are separate and distinct estates,[64] differing both in their requirements of creation[65] and in the incidents by which they are characterized.[66] As a result, the court has created confusion by rendering an anomalous decision without clearly and precisely defining its position.[67] The vagueness of the opinion raises

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[57] The rationality of this conclusion is not affected by the court's statement that in Mississippi "the dissolution of a marriage does not, of itself, affect title of the respective parties to real estate owned by them." *Id.*; *see* note 20 and accompanying text *supra*.

[58] As early as 1951, it was noted that in Mississippi there was an absence of modern judicial distinction between the two estates. Phipps, *supra* note 15, at 33. *Wolfe* was cited in support of this observation. *Id.* at 33 n.27; *see* W. POWELL, *supra* note 20, § 621, at 619-20 & n.3; 4 G. THOMPSON, *supra* note 7, § 1784, at 53.

[59] 336 So. 2d at 499.

[60] *Id.*

[61] The court apparently used the term "tenancy by the entirety" to denote a joint tenancy held by husband and wife. *Id.*

[62] *Id.*

[63] *See* notes 6, 10 through 20 and accompanying text *supra*.

[64] 4 G. THOMPSON, *supra* note 7, § 1784, at 54; Phipps, *supra* note 15, at 35.

[65] See note 6 *supra*.

[66] See notes 12 through 17, 39 & 40 and accompanying text *supra*.

[67] Only confusion can result from failure to make clear the distinction between the two estates and the requirements necessary for the existence of each, in view of their differing incidents.
Note, *supra* note 7, at 216.

three possibilities concerning the court's present position on tenancies by the entirety. One possibility is that the court has simply failed to recognize the common law distinction between the two estates. However, both the history of the court[68] and the language used in *Cuevas*[69] render this possibility unlikely. Another possibility is that the court has created a hybrid estate,[70] having incidents of both a joint tenancy and a tenancy by the entirety.[71] This view also seems unlikely inasmuch as the element of inseverability would remain an incident of the estate.[72] The final possibility, best supported by the instant decision[73] and recent cases, is that the court no longer recognizes any distinction between tenancies by the entirety and joint tenancies.[74] This conclusion is consistent with both the modern trend[75] and past treatment of entireties upon divorce.[76] Moreover, this view is consistent with the present statute, which erroneously states that a tenancy by the entirety has a right of survivorship[77] and further obfuscates the distinction between the two tenancies by apparently permitting an estate by the entirety to be created by a conveyance "from the owner or owners to himself, themselves, and others."[78] Taking this view as the present position of the court, it would appear that the correct conclusion was reached in *Shepard*.

Regardless of the correctness of the instant decision, the status of a tenancy by the entirety in Mississippi remains uncertain. Further, the court's imprecision could have serious ramifications in other areas of the law, such as tax,[79]

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[68] See note 25 and accompanying text *supra*.

[69] See notes 45 through 46 and accompanying text *supra*.

[70] The possibility of a hybrid estate exists if the opinion in *Cuevas* can be considered an accurate indication of the court's position. See note 45 *supra*.

[71] In *Cuevas*, the court stated that a tenancy by the entirety could not be unilaterally severed. 191 So.2d at 846. As in *Miller*, however, the court in the instant case stated that the estate held by husband and wife was not affected by divorce. 336 So.2d at 499. Consequently, the exact nature of the estate held by the parties after divorce is not clear.

[72] See notes 71 *supra* & 75 *infra*.

[73] 336 So. 2d at 499.

[74] *See* notes 36 through 41, 52, 56 & 58 and accompanying text *supra*. This view is especially persuasive if *Cuevas* has been overruled by implication or if the opinion in *Cuevas* was tailored to give full faith and credit to the Georgia decree. See note 45 *supra*.

[75] The element of inseverability of estates by the entirety except upon agreement by the parties, when viewed in connection with the present day high incidence of marital separation and divorce, indicates an undesirable restriction upon the alienability of property.

Note, *supra* note 7, at 217; *see, e.g.*, Phipps, *supra* note 15, at 45; 1 ALA. L. REV. 100, 102 (1948); 15 N.Y.L. REV. Q. 138, 139 (1937). *See also* Tyler v. United States, 281 U.S. 497 (1940) (refused to allow a "fiction of the common law" to prevent collection of federal estate tax). For a survey of how other states have abrogated or altered tenancies by the entirety, see, *e.g.*, W. POWELL, *supra* note 20, § 623, at 622-25; 4 G. THOMPSON, *supra* note 7, §§ 1784-85, at 47-64; Phipps, *supra* note 15.

[76] Only three other states had previously reached decisions similar to that of the present case. All three have since changed these by statute. See note 20 *supra*.

[77] See note 2 *supra*. *See also* note 14 *supra*.

[78] See note 2 *supra*; *see* note 10 *supra*.

[79] For example, a spouse-donor may elect to treat the creation of a joint tenancy or tenancy by the entirety as a gift.The amount of the gift is the value of the donor's retained interest deducted from the value of his contribution. In a joint tenancy, the value of the

bankruptcy,[80] access by creditors,[81] alienability[82] and divorce.[83] As a result, it becomes unimportant whether the legislature or the court individually are at fault or whether the statutes and the opinions collectively produced the confusing decision in *Shepard*. What is important is that the inevitable result of such confusion—needless litigation—must be prevented by prompt judicial clarification or conclusive legislative enactment.

Tommy E. Furby

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retained interest is one-half the value of the property. In a tenancy by the entirety, however, the value of the retained interest is determined by actuarial methods using the life expectancies of the spouses. Thomas, *Tax Consequences of Tenancies*, 22 PRAC. LAW. 57, 60-61 (June 1976).

[80] The Bankruptcy Act provides that an individual, a corporation or a partnership may become bankrupts. If the estate is held by tenants by the entirety and only the husband is subject to the bankruptcy proceedings, the trustee in bankruptcy has no authority over the wife's estate unless both spouses are in bankruptcy. Craig, *An Analysis of Estates by Entirety in Bankruptcy*, 48 AM. BANK. L.J. 255, 261-69 (1974).

[81] *See, e.g.*, 4 G. THOMPSON, *supra* note 7, § 1790, at 84-93; Phipps, *supra* note 15, at 46-47. See note 16 *supra*.

[82] See note 14 *supra*; *see, e.g.*, Phipps, *supra* note 15, at 46-57.

[83] *See* notes 5 &20 and accompanying text *supra*.

Domestic Relations—Child Support—Parental Duty To Support A Subnormal Adult Child

Plaintiff, mother of a mentally deficient adult child, brought an action to have the child's father held in contempt of court for discontinuing monthly support payments established in a 1964 divorce decree.[1] Plaintiff contended that the support payments should be continued beyond the child's majority because he was incapable of fully maintaining himself.[2] Defendant alleged that his legal responsibility to the child under the divorce decree terminated at the age of majority.[3] The trial court declared the defendant in contempt of court for failing to support the child. On appeal to the Mississippi Supreme Court, *held,* reversed and rendered. A child support decree terminates upon the child's attaining the age of majority, and a contempt proceeding is an inappropriate action to determine the existence of a parental duty to support an adult retarded child. *Watkins v. Watkins*, 337 So. 2d 723 (Miss. 1976).

At common law, the parent's legal obligation to support was restricted to minor children of the marriage.[4] Consequently, in the absence of statutory, contractual or constitutional provisions, the parental duty to support automatically terminated at the age of majority.[5] Indeed, strict application of this limita-

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[1] Under the divorce decree, plaintiff, Necie S. Watkins, was awarded custody of the 13-year-old child and $35 per month as child support. Watkins v. Watkins, 337 So. 2d 723, 724 (Miss. 1976). Defendant, Johnnie Fred Watkins, discontinued the support payments when the child reached 21 years of age. *Id.*

[2] The evidence indicated that while the child's retardation prevented him from fully maintaining himself, his annual earning capacity approached $800 to $900. *Id.*

[3] *See id.*

[4] *See* Hobbs v. Lokey, 37 Del. 408, 183 A. 631, 632 (1936); Wright v. Coleman, 137 Miss. 699, 705, 102 So. 774, 776 (1925). Those seeking to justify the support obligation generally have traveled one of three avenues. The first, and perhaps most significant, position is that the duty arises from the obvious incapacity of minor children to independently care for and maintain themselves. Also, such an obligation has been said to arise from principles of natural law which mandate parental provision for those whom they beget. Finally, it has been advanced that the support requirement forecloses the undesirable alternative of resorting to the state treasury for child support payments. State *ex rel.* Kramer v. Carroll, 309 S.W.2d 654, 658 (Mo. Ct. App. 1958).

At common law, the primary responsibility for the support of minors fell upon the father, *see* Johnson v. State, 22 Ala. App. 160, 113 So. 480, 481 (1927), theoretically as a basic tenet of the marriage contract. Kearney v. Kearney, 178 Miss. 766, 772, 174 So. 59, 60 (1937). While in the absence of statute the common law placed no support liability upon the mother, *see, e.g., In re* Kasner's Estate, 175 Misc. 832, 25 N.Y.S.2d 488, 491 (Sur. Ct. 1941), the statutory emancipation of the mother vested her with equal legal responsibility for child support. Girls' Latin School v. Hart, 317 Ill. App. 382, 46 N.E.2d 118, 122 (1943); *see* White v. White, 71 Cal. App. 2d 390, 163 P.2d 89, 90 (Dist. Ct. App. 1945). To be sure, the father's duty has been denominated as a continuing one, affected neither by divorce nor an award of custody to the mother. Rasch v. Rasch, 168 So. 2d 738, 744 (Miss. 1964).

[5] *See* Wood v. Executors of Gill, 1 N.J.L. 512, 515 (1795). The court in Napa State Hosp. v. Flaherty, 134 Cal. 315, 66 P. 322 (1901), determined that any duty to support an adult child was "purely a creation of . . . statute" since "[n]o such right existed at common law." 66 P. at 323; *accord*, Wright v. Coleman, 137 Miss. 699, 705, 102 So. 774,

tion denied assistance not only to "normal" adult children,[6] but also to mentally and physically impaired offspring.[7] Some courts, however, rather than apply the arbitrary fixed-period-of-support rule, held that the parental duty also terminated when a physically and mentally able minor voluntarily relinquished the family shelter and embarked on his own account.[8] Unfortunately, many courts continue to exhibit a more substantial degree of reluctance to extend the duty of support beyond majority than to terminate it upon the child's emancipation. Specifically, cases presenting the question of a parental duty to supply "necessaries" to adult children provide a backdrop for the continuing evolution of post-majority support.

"Necessaries" have been obscurely defined as those articles necessary for the "support of the body and improvement of the mind of the infant."[9] The expansive nature of this definition has been a harbinger of a plethora of provisions eventually included within the necessity concept.[10] Ironically, however, those most in need of such support too often have been denied assistance simply because they had reached majority. For example, some courts, while recognizing the father's duty to furnish necessary medical services to a minor child, have found no corresponding duty to an adult child.[11] Other courts, however, have

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776 (1925). In Sheneman v. Manring, 152 Kan. 780, 107 P.2d 741 (1940), the court rejected the harsh common law principle and substituted "the more humane rules of the civil laws" to require the guardian of an indigent adult daughter to pay for legal services rendered to the child. 107 P.2d at 742.

[6] Childers v. Childers, 229 Ark. 11, 313 S.W.2d 75, 77 (1958)(father's duty to continue monthly support payment ceases upon majority of daughter); Worthington v. Worthington, 207 Ark. 11, 179 S.W.2d 648, 649 (1944) (support duty terminates at age of majority in absence of contractual agreement to continue).

[7] *E.g.*, Kizer v. Kizer, 135 Ind. App. 8, 191 N.E.2d 332, 333-34 (1963) (father relieved of liability for medical, hospital or institutional expenses incurred by adult son); Monroe County v. Teller, 51 Iowa 670, 2 N.W. 533, 534 (1879) (father owed no more duty of support to insane adult son than he would a "stranger"); Citizen's State Bank v. Shanklin, 174 Mo. App. 639, 161 S.W. 341, 344 (1913) (denial of claim against father's estate for expenses incurred during adult daughter's protracted illness and subsequent death); Kinsey v. Kinsey, 200 Misc. 760, 107 N.Y.S.2d 212, 218 (Dom. Rel. Ct. 1951) (mentally deficient and epileptic adult son denied support).

[8] *E.g.*, Rounds Bros. v. McDaniel, 133 Ky. 669, 118 S.W. 956, 958 (1909); Brosius v. Barker, 154 Mo. App. 657, 136 S.W. 18, 20 (1911). This concept—emancipation—has been defined as "an entire surrender of all the rights to the care, custody, and earnings of the child, as well as a renuniciation of parental duties." 136 S.W. at 19. Emancipation of a child may occur in one of several ways: (1) parental action; (2) marriage; (3) reaching the age of majority; or (4) voluntary self support. Warren v. Long, 264 N.C. 137, 141 S.E.2d 9, 10 (1965).

[9] Utterstrom v. Myron D. Kidder, Inc., 124 Me. 10, 124 A. 725, 725 (1924).

[10] *See, e.g.*, Wiggins Estate Co. v. Jeffrey, 246 Ala. 183, 19 So. 2d 769, 776 (1944) (taxes against a minor's property); Strong v. Foote, 42 Conn. 203, 205 (1875) (tooth repairs); Cidis v. White, 71 Misc. 2d 481, 336 N.Y.S.2d 362, 363 (Dist. Ct. 1972) (contact lenses); Levy v. Kaufman, 26 Misc. 2d 57, 219 N.Y.S.2d 91, 92 (Sup. Ct. 1960) (legal services rendered on behalf of child).

[11] *E.g.*, Blackley v. Laba, 63 Iowa 22, 18 N.W. 658, 658 (1884); *see* Crane v. Baudouine, 55 N.Y. 256, 259 (1873).

refused to condone such inequity. For example, in *Crain v. Mallone*,[12] the Kentucky Court of Appeals found no realistic distinction between the parental duty to support an infant and the obligation to care for an insane adult described as "equally, if not more, dependent upon the parent"[13] for its maintenance than a normal child. Similar humanitarian sentiments mollified the harsh common law rule by laying the groundwork for ad hoc determinations of the existence of a continuous support duty.[14] In *Brown v. Ramsey*,[15] the Supreme Court of New Jersey held that emancipation of a mentally incompetent child was a question of fact rather than law and, consequently, no change in the parent-child relationship would be presumed from the mere attainment of majority.[16] Additionally, the *Brown* court explained that despite his legal status as an adult, the child could remain unemancipated either through election or incapacity and thus continue to receive support from his father.[17] Although denominated as "continuous," the duty to support does not linger indefinitely, but terminates when the necessity no longer exists.[18]

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[12] 130 Ky. 125, 113 S.W. 67 (1908).

[13] *Id.* at 126, 113 S.W. at 68.

[14] *See, e.g.*, Ellenbarger v. Swiggetti, 1 Ind. App. 598, 28 N.E. 110, 111 (1891) (suit to recover cost of goods, wares and merchandise furnished to adult son); Hoover v. Voughtman, 103 N.J. Super. 535, 248 A.2d 136, 138-39 (Dom. Rel. Ct. 1968) (court declared education to be a necessity in allowing post-majority support for college education); Kruvant v. Kruvant, 100 N.J. Super. 107, 241 A.2d 259, 264 (Super. Ct. App. Div. 1968) (father possibly could be ordered to contribute to cost of necessaries for support of mentally ill adult child where subnormal condition preceded majority); *In re* Van Denburgh, 178 App. Div. 237, 164 N.Y.S. 966, 967 (1917) (duty to pay for adult daughter's funeral expenses).

[15] 29 N.J.L. 117 (1860).

[16] *Id.* at 121.

[17] *Id.* at 120.

[18] Pocialik v. Federal Cement Tile Co., 121 Ind. App. 10, 97 N.E.2d 360, 363 (1951); Schultz v. Western Farm Tractor Co., 111 Wash. 351, 190 P. 1007, 1007-08 (1920); *see* Upchurch v. Upchurch, 196 Ark. 324, 117 S.W.2d 339, 340 (1938).

In light of the broad recognition of post-majority support for incapacitated adult children, such support should not be denied simply because of a child's age. *See* Wells v. Wells, 227 N.C. 614, 44 S.E.2d 31, 34 (1947); Sayne v. Sayne, 39 Tenn. App. 422, 284 S.W.2d 309, 311-12 (1955). Indeed,

> "the child may have the same need of support, care and maintenance after reaching that age [majority] as before. If so, does the obligation of the father to provide necessary support to such child terminate at that time? The dictates of humanity, which the law follows, answer 'No'."

284 S.W.2d at 311 (citation omitted).

Beyond emancipation, it should be noted that private contractual agreements except post-majority relief from the common law rule. *See* Blumenthal v. Blumenthal, 161 A.2d 137, 139-40 (D.C. 1960) (agreement extending support beyond majority). *See also* Kamper v. Waldon, 17 Cal. 2d 718, 112 P.2d 1, 2 (1941) (agreement requiring continued support of adult married daughter); Reinschmidt v. Dorough, 14 Ga. App. 409, 81 S.E. 252, 252 (1914) (contractual duty to pay for medical services for adult son); Church v. Hancock, 261 N.C. 764, 136 S.E.2d 81, 82 (1964) (contract binding despite emancipation by marriage). In Vineberg v. Vineberg, 177 So. 2d 367 (Fla. Dist. Ct. App. 1965), a property settlement provision required the father to make annual payments to his ex-wife for the

Several jurisdictions have codified an expansive child support concept in the form of family responsibility laws.[19] Moreover, judicial interpretation of state pauper laws has been utilized to encompass post-majority support obligations in the absence of more specific statutory provisions.[20] For example, in *Holsomback v. Slaughter*,[21] the Mississippi Supreme Court held that under a state indigency law,[22] the mother had a duty to support an adult daughter temporarily confined in a mental institution.[23] These various indications of munificient post-majority support orders were, unfortuntely, later modified by a number of judicially created restrictions and narrow statutory interpretations. For example, some jurisdictions have circumscribed the common law exception by granting post-majority support only where the child incurred the subnormal condition prior to majority and continued to live with one of the parents.[24] And, in *Anonymous v. Anonymous*,[25] a New York domestic relations court achieved a similar result by providing for post-majority support where the evidence indicated that, in the absence of a support order, the dependent adult was "likely to become a public charge."[26] Still other courts, unwilling to arbitrarily deny support upon majority, have developed procedural limitations whereby a presumption against a parental support duty can be overcome by evidence of mental or physical incapacity.[27] More recently, a Pennsylvania court[28] recognized a

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benefit of his unmarried children. The court employed this provision to impose a post-majority support obligation upon the father even though the child whose support was in issue had reached majority and was gainfully employed. *Id.* at 368.

[19] *E.g., California:* CAL. CIV. CODE § 241 (West 1954); *Illinois:* ILL. REV. STAT. ch. 68, §§ 51, 52 (1959); *Minnesota:* MINN. STAT. ANN. § 518.54(2) (West 1959); *New York:* N.Y. DOM. REL. LAW § 32(4) (McKinney 1964); *Oregon:* ORE. REV. STAT. § 416.010 (1975).

[20] *See, e.g.*, State v. Griffiths, 152 Conn. 48, 203 A.2d 144, 147 (1964) (father required to make support payments to married daughter pursuant to state aid to dependent children program); Davis v. Davis, 246 Iowa 262, 67 N.W.2d 566 (1954). In *Davis*, the court considered both the common law exception of post-majority support for adult incapacitated children, as well as the likelihood of the child becoming a public charge. In so doing, the court interpreted an Iowa support-of-dependents statute to impose a continuing duty of support on the father of a mentally deficient adult. 67 N.W.2d at 568, 572. *See also* Williams v. West, 258 S.W.2d 468, 472 (Ky. 1953) (action against father of incapacitated adult child for past and future support under dependent children support statute); Tharp v. Tharp, 438 S.W.2d 391, 393, 394 (Tex. Civ. App. 1969) (action for modification of divorce decree requiring father to support adult son under statute authorizing support for children in need of custodial care).

[21] 177 Miss. 553, 171 So. 542 (1937).

[22] ANN. MISS. CODE § 5706 (1930) (current version at MISS. CODE ANN. § 43-31-25 (1972)).

[23] 177 Miss. at 561, 171 So. at 543.

[24] Murrah v. Bailes, 225 Ala. 178, 50 So. 2d 735, 737 (1951); Gaydos v. Domabyl, 301 Pa. 523, 152 A. 549, 553 (1930); *see* Warren v. Long, 264 N.E. 137, 141 S.E.2d 9, 10 (1965) (adding requirement that mentally deficient adult be unmarried).

[25] 173 Misc. 679, 18 N.Y.S.2d 806 (Dom. Rel. Ct. 1940).

[26] 18 N.Y.S.2d at 811. *See also* Betz v. Horr, 250 App. Div. 457, 294 N.Y.S. 546, 548 (Sup. Ct. 1937).

[27] *E.g.*, Wells v. Wells, 227 N.C. 614, 44 S.E.2d 31, 34 (1947). In Commonwealth *ex rel.* O'Malley v. O'Malley, 105 Pa. Super. 232, 161 A. 883, 884-85 (1932), the court declared

test under which post-majority support will not be denied unless the child is "physically and mentally able to engage in [available] profitable employment . . . at a supporting wage."[29]

The indecisiveness encumbering the recognition of a post-majority support duty is equally perceptible in judicial attempts to interpret ambiguous statutory support provisions. Typically, state support statutes refer only to "children" without denominating the exact parameters of the term.[30] Additionally, many courts regard divorce as a statutory procedure devoid of jurisdictional authority to order support for an incapacitated adult child unless expressly conferred.[31] To the contrary are courts which exercise their jurisdiction to resolve the parental duty issue unless the word "children" is statutorily limited specifically to those under the age of majority. For example, in *Maitzen v. Maitzen*,[32] an Illinois court construed the absence of a legislative definition of the word "children" to negative any legislative intent to establish a single age at which a parent was excused from child support liability.[33] Naturally, ambiguous statutes, which ar-

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that a presumption exists that the reciprocal duties between father and child terminate when the child reaches majority. The court added, however, that the presumption was overcome by evidence indicating "that either party is incapable of self-support." *Id.*

[28] Commonwealth *ex rel.* Groff v. Groff, 173 Pa. Super. 535, 98 A.2d 449 (1953).

[29] 98 A.2d at 450-51.

[30] *See, e.g.*, MISS. CODE ANN. § 93-5-23 (1972), which provides in pertinent part:

> When a divorce shall be declared from the bonds of matrimony, the court may, in its discretion, having regard to the circumstances of the parties and the nature of the case, as may seem equitable and just, make all orders touching the care, custody and maintenance of the children of the marriage . . . . The court may afterwards, on petition, change the decree, and make from time to time, such new decrees as the case may require. However, where proof shows that both parents have separate incomes or estates, the court may require that each parent contribute to the support and maintenance of the children of the marriage in proportion to the relative financial ability of each.

[31] *See, e.g.*, Reynolds v. Reynolds, 274 Ala. 477, 149 So. 2d 770, 772 (1961); Baril v. Baril, 354 A.2d 392, 395, 396 (Me. 1976); Johnstone v. Johnstone, 130 Misc. 243, 223 N.Y.S. 744, 747, 748 (Sup. Ct. 1927). *See also* Commonwealth *ex rel.* O'Malley v. O'Malley, 105 Pa. Super. 232, 161 A. 883, 885 (1932) (desertion and nonsupport statute contained only the word "children").

[32] 24 Ill. App. 2d 32, 163 N.E.2d 840 (1960).

[33] 163 N.E.2d at 843. The pertinent part of the divorce act stated that upon granting a divorce, the court

> may make such order touching . . . the care, custody and support of the children . . . as, from the circumstances of the parties and the nature of the case, shall be fit, reasonable and just, [and] may, on application, from time to time, make such alterations in . . . the care, custody and support of the children, as shall appear reasonable and proper.

Id. at 842-43, *quoting* ILL. REV. STAT. ch. 40, § 19 (1959). The court went on to explain that "jurisdiction over children of broken homes . . . is not dependent upon statutes, . . . but is an inherent power of equity." 163 N.E.2d at 843. Further, the court opined that the legislature intentionally left the term "children" undefined to ensure the degree of flexibility required in an everchanging society. *Id. Compare* Perla v. Perla, 58 So. 2d 689, 690 (Fla. 1952) *with* Finchman v. Levin, 155 So. 2d 883, 884 (Fla. Dist. Ct. App. 1963).

guably limit support to "minor children,"[34] restrict the courts' discretion to create a post-majority duty.[35] Such limitations, however, are not insurmountable. In *Sayne v. Sayne*,[36] for example, the Tennessee Court of Appeals ordered a father to support his disabled 27-year-old daughter despite a jurisdictional divorce statute which limited such support to "minor children."[37] Recognizing the problems inherent in ambiguous "minor children" statutes, some state legislatures have altered their statutes to define "child" as one under the age of majority *or* one who is unable to support himself because of mental or physical disabilities.[38] Such a curative measure is particularly appealing in light of the rather sinister omnipresence of the common law rule which, as previously noted, some courts are unwilling to discard.[39]

In the instant case, the court ruled that since the pertinent child support statutes were applicable only to minors,[40] and since there was no statutory

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[34] *E.g.*, MISS. CODE ANN. § 93-11-65 (1972), which provides in pertinent part:

> In addition to the right to proceed under section 93-5-23, Mississippi Code of 1972, and in addition to the remedy of habeas corpus in proper cases, and other existing remedies, the chancery court of the proper county shall have jurisdiction to entertain suits for the custody, care, support, and maintenance of minor children and to hear and determine all such matters. . . .
>
> Provided further, that where the proof shows that both parents have separate incomes or estates, the court may require that each parent contribute to the support and maintenance of the children of the marriage in proportion to the relative financial ability of each.

See IND. CODE § 31-1-12-15 (1971); TENN. CODE ANN. § 36-828 (1975).

[35] *Cf.* Young v. Young, 413 S.W.2d 887, 888 (Ky. 1967) (legal duty to provide educational support terminated at majority and court thus without jurisdiction to award it); Perla v. Perla, 58 So. 2d 689, 690 (Fla. 1952) (no authority in divorce action to compel father of disabled adult child to contribute support); Borchert v. Borchert, 185 Md. 586, 45 A.2d 463, 466-67, (1946) (no authority to amend divorce decree to require support of disabled son).

[36] 39 Tenn. App. 422, 284 S.W.2d 309, 310-12 (1955).

[37] 284 S.W.2d at 310. The relevant portion of the statute provided that

> [i]n a suit for annulment, divorce, or separate maintenance, when the custody of a minor child or minor children is a question, the court may . . . decree that suitable support be made by the father.

TENN. CODE § 8454 (1955) (current version at TENN. CODE § 36-828 (Supp. 1975)). The court, however, ruled the statutory language neither expressly nor implicitly limited the power of the court to command support payments by the father. 284 S.W.2d at 311.

[38] *See, e.g.*, Kiesow v. Kiesow, 270 Minn. 374, 133 N.W.2d 653, 660 (1965), *citing* MINN. STAT. ANN. § 518.54 (2) (1959). *See also* CAL. CIVIL CODE § 241 (West 1970).

[39] *See* note 7 and accompanying text *supra*.

[40] The court pointed out that the 1964 support decree was entered under authority of MISS. CODE ANN. § 93-5-23 (1972), which empowers the divorce court to "make all orders touching the care, custody, and maintenance of the children of the marriage." Further, the opinion recognized that the statute does not expressly limit the court's power to minor children. The court concluded, however, that the enactment of MISS. CODE ANN. § 93-11-65 (1972), which provides for remedies for support, maintenance, and custody of "minor children," "in addition" to the right to proceed under 93-5-23, and "in addition" to the remedy of habeas corpus, was a legislative recognition that the term "children" in 93-5-23 should be construed to denote "minor children." 237 So. 2d at 724.

conferment of jurisdiction upon the trial court to impose a continuing duty to support adult children under a divorce decree,[41] the support decree for the mentally incapacitated adult child terminated when he reached majority.[42] The court further reasoned that since the support decree terminated at majority, the contempt proceeding was an inappropriate action to determine whether the father owed a legal duty to financially maintain his adult retarded child.[43]

At first blush, the decision in the instant case might well be construed to add a new and more unthinking clause to the definition of "inequitable." Indeed, it is submitted that no plausible moral argument exists to justify a father abandoning his severely disabled child. Any such argument would shock the conscience of any compassionate or socially responsible person. Upon closer and less emotional scrutiny, however, the court's decision in *Watkins* becomes truly reflective of the interminable war between law and equity in which a timid judiciary will too often fight alongside the law. Thus, while *Watkins* certainly may be categorized as "wrong" in a broad sense, it is not incorrect. A contempt proceeding concededly is not the correct procedure for enforcing a heretofore non-existent legal duty. Nevertheless, *Watkins* must not be interpreted to foreclose the possibility that, when other means are used,[44] a duty to support will be recognized. As Justice Smith noted in his concurrence, the precise question of whether a legal duty to support adult incapacitated children exists was not presented in *Watkins*.[45] Similarly, the remainder of the court considered such a decision "inappropriate" since the propriety of a contempt proceeding rather than the legal duty was directly in issue.[46] The unanswered questions thus be-

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[41] Although the court did not express an opinion on such a legal duty of support, it did recognize a "strong" moral duty. *Id.* at 725.

[42] *Id.* at 724.

[43] *Id.* In a special concurrence, Justice Smith emphasized that the court's holding would not control his future opinion as to the precise extent of retardation required to impose upon parents a legal duty to continue support of an adult child. *Id.* at 725 (Smith J., concurring).

[44] The most economical means of implementing a parental duty to support would be to incorporate the terms of the post-majority obligation into the original decree. Thus, the chancellor would be in a position not only to determine the necessity for and amount of support, but also to entertain modification petitions as the need arose. With respect to existing decrees which make no provision for post-majority support, the remedy would be to modify the decree. The anticipated case in which the court will finally decide the post-majority support issue probably will arise where, after a pre-majority modification is granted the mother and the child subsequently reaches majority, the father refuses further payments. Thus, in considering the ensuing contempt proceeding, the court would first be forced to determine the validity of the modification. Alternatively, the father could simply appeal the original decree or modification.

Again, the problem is jurisdictional since *Watkins* did not specifically resolve the manner in which "child" should be construed. *See* text accompanying notes 56 through 59 *infra*. Hopefully, the legislature will cure the problem created by the definition of "child" by amending the applicable statutes to include incapacitated adult children. In this respect,the legislature would be well-advised to consult the Minnesota statute as a model. *See* note 19 and accompanying text *supra*.

[45] 337 So. 2d at 725 (Smith, J., concurring).

[46] *Id.* at 724-25.

come whether, in a future case where the support issue is clearly presented, the court will recognize a duty and, if it does, what rationale it will employ to support such recognition.

There is little doubt that the court has previously recognized and implemented similar duties in analagous circumstances. In *McNeese v. Conwill,*[47] for example, the court recognized that a husband must support his insane wife for "as long as he is able."[48] Certainly the common law duty of a husband to support his wife, upon which *McNeese* was decided, is no stronger than the common law duty of a father to support his children. Further and more direct support is provided by the court's decision in *Pass v. Pass.*[49] Based upon a petition for modification of an existing divorce decree, *Pass* held that to preclude a social disadvantage to his child, a father has a duty to provide funds for the child's college education.[50] Of greater import in the context of the instant case is the fact that *Pass* did not expressly limit the father's duty to the minority years of the child's college education. Presumably the duty extends beyond majority.[51] By any standard, provision for the necessaries of a mentally deficient child merits the same judicial recognition accorded educational assistance to a "normal" child of post-majority years. There is simply no reason for the handicapped child as well as society[52] to assume the entire burden of a broken marriage.

The *Watkins* court, while recognizing the father's "strong moral duty"[53] to support, explained that it was constrained by the relevant statutes from implementing a corresponding legal duty.[54] The problem, of course, is that section 93-5-23 refers only to "children of the marriage"[55] whereas section 93-11-65 refers in places to "minor children."[56] Based upon this distinction, the court speculated that the latter section revealed a legislative intent to limit the words "children of the marriage" in 93-5-23 to minor children.[57] Such a construction of 93-11-65 is inappropriate. As the court noted,[58] that section provides remedies "*[i]n addition* to the right to proceed under section 93-5-23 . . . ."[59] Despite a

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[47] 177 Miss. 427, 170 So. 678 (1936).

[48] *Id.* at 429, 170 So. at 679.

[49] 238 Miss. 449, 118 So. 2d 769 (1960).

[50] *Id.* at 459, 118 So. 2d at 773.

[51] The child in *Pass* would have reached majority during the course of her college education. The court, while at all times referring to the father's duty to provide an education for his "minor child," viewed the college education as a whole without regard to that portion which would be received after majority. *Id.*

[52] Deprivation of the father's financial contribution could force the mother and child to resort to public assistance. This not only would create an undesirable social policy in the state with regard to handicapped children, but also would add unnecessarily to the taxpayers' burden.

[53] 337 So. 2d at 725.

[54] *Id.* at 724.

[55] MISS. CODE ANN. § 93-5-23 (1972). See note 30 *supra.*

[56] MISS. CODE ANN. § 93-11-65 (1972). See note 34 *supra.*

[57] 337 So. 2d at 724.

[58] *Id.*

[59] MISS. CODE ANN. § 93-11-65 (1972) (emphasis added).

contrary indication by the court,[60] the words "in addition to" imply a disjunction of the statutes rather than a consolidation. Thus, the statutes should be read to compliment rather than control each other. Moreover, the court's statement that 93-11-65 constituted a legislative recognition that the term "children" in 93-5-23 was used to describe minor children[61] is not fully supported by the language of the former section. Although parts of 93-11-65 employ "minor" to modify "children," other parts use, with greater frequency, the words "children of the marriage."[62] Contrary to the court's interpretation, this usage reflects legislative confusion rather than legislative intent. Indeed, it is inconceivable that the same legislature which has enacted special provisions for state-supported care of handicapped persons[63] would have intended for the chancery courts to be powerless to extract support from the parents of such individuals.

While in the final analysis *Watkins* may have been decided correctly on its facts, it could, unfortunately, precipitate an extremely unreasonable future decision. It is hoped that the court will reconsider its limited construction of the word "children" in section 93-5-23. A more flexible construction certainly would not offend accepted practices of statutory construction. Chronological age is simply too inexact a tool with which to measure the maturity and self-sufficiency of a handicapped person. Its continued use will only further cripple an already deprived class of Mississippi citizens.

John Edward Milner

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[60] 337 So. 2d at 724.

[61] *Id.*

[62] More precisely, "minor children" is used in the statute only twice, whereas "children of the marriage" is used three times and "children" once. *See* MISS. CODE ANN. § 93-11-65 (1972).

[63] *See, e.g.,* MISS. CODE ANN. §§ 43-3-51, -57 (1972) (blind persons); *Id.* § 41-19-39 (special tax to aid mental retardation facilities).

BOOK REVIEWS

LAWYERS' ETHICS IN AN ADVERSARY SYSTEM

BY MONROE H. FREEDMAN

Indianapolis: The Bobbs-Merrill Company, Inc., 1975

Pp. 270 $12.50

*N. S. Sweat, Jr.**

Long cherished ideals, settled concepts and established practices are under frequent, heavy attack in many areas of life. In the vanguard of the assault is Dean Monroe Freedman of the Hofstra University Law School, a highly controversial man, who has written a biting book on the lawyer's ethical responsibilities in the adversary system. True to the nature of Dean Freedman's past endeavors, this critique is destined to elicit opposition.

The author employs an unusual style as he spiritedly pursues such historically "ignored" or "avoided"[1] ethical problems as conflicts of interest, disciplinary rules, professional practices and virtually anything else that gets in his way. Dean Freedmen is not timid. He is a man of strong bias and attacks the problems head-on, sideways and backwards. He displays positive enthusiasm and impatience. Frequently unreasonable, his comments stop me as I read, and I soon begin to feel that he would indict all prosecutors and hold the courts in contempt. Although ostensibly only a discussion of "extraordinarily difficult if not [impossible]"[2] conflicts encountered in practice under the Code of Professional Responsibility, his book ultimately is an assault upon the adversary system itself.

Dean Freedman states that the purposes of his book are to stimulate responsible discussion of ethical dilemmas posed by the adversary system and to suggest some answers. Many of his answers are realistically unacceptable, but there can be no doubt that he succeeds in provoking discussion.[3]

The book covers a wide variety of topics and almost every one of them is contentious. The first chapter finds that in the adversary system the obligation of confidentiality is supreme under almost all conceivable conditions, at least in criminal cases.

Comparing the concepts of zealous advocacy and the public interest in chapter two, the author demonstrates little interest in the public interest. The judicial search for truth appears almost incidental. Courtroom disruption is obviously a matter of no great concern to him.

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* B.S.C. 1946, J.D. 1949, University of Mississippi; LL.M. 1952, George Washington University; Professor of Law, University of Mississippi and Director of the Mississippi Criminal Justice Institute.

[1] M. FREEDMAN, LAWYERS' ETHICS IN AN ADVERSARY SYSTEM vii (1975).

[2] *Id.* at ix.

[3] *E.g.*, Strick, *Requiem for the Adversary System*, 7 JUR. DOCTOR 18 (Feb. 1977).

"Is it ever proper for a criminal lawyer to present perjured testimony?"[4] In the third chapter, Dean Freedman says that while the instinctive answer is "no," he answers in the affirmative. Indeed, he maintains that a criminal defendant's lawyer must *never* reveal a client's confidences. If the client decides to perjure himself and makes the attorney privy to that determination, the attorney must accept that decision and proceed "in the normal fashion"[5] to present the perjured testimony and to argue the perjured testimony to the jury. After all, the author states, if counsel refuses to present the testimony, the client can find one who will.

In chapter five, the book discusses what a lawyer "really knows."

The sixth chapter reasons that since a witness' memory is only reconstructed recollection, an effective attorney should play a significant role in the reconstruction.

Citing plea bargaining and other procedures employed in criminal cases, the author makes it clear in chapter seven that he is in great and growing disagreement with prosecutors and their practices. He concludes: "The law, in its even-handed majesty, permits the innocent as well as the guilty to plead guilty . . . to avoid the threat of extended imprisonment."[6]

The next chapter launches an assault on the proposed certification of trial lawyers.

Chapter nine interestingly declares that the vaunted superiority of the British judicial system is but a myth.

The final chapter Dean Freedman entitles ". . . The Professional Obligation to Chase Ambulances."[7]

All of this calls for at least two careful readings. Initially, I was not prepared for it. What you find, however, is guaranteed to stimulate your cerebral processes and to exercise your adrenal glands. While the author recognizes that his views will not be acceptable to a majority of practitioners, he defiantly brands himself as a modern Robin Hood, crusading against an antagonistic system. "But," he offers, "Robin Hood . . . was an outlaw."[8]

To many of us who constantly study and monitor our system, there appears to be at times an almost imperceptible, sometimes seemingly inexorable movement towards some form of continental system. Witness, in addition to the increasing attacks on the adversary and criminal justice systems, ethical rules, conflicts and dilemmas, the growing role of the judge in trial work. Of course, we must keep open minds and always strive for improvement. We must, however, carefully determine as best we can what constitutes very real improvement. Thus, I am glad that I read this book. I plan to keep it on my desk for a while as a disturbing influence.

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[4] M. FREEDMAN, *supra* note 1, at 27.
[5] *Id.* at 36.
[6] *Id.* at 87.
[7] *Id.* at 113.
[8] *Id.* at 76.

UNION REPRESENTATION ELECTIONS: LAW AND REALITY

BY JULIUS G. GETMAN, STEPHEN B. GOLDBERG & JEANNE B. HERMAN

New York: Russel Sage Foundation, 1976

Pp. 163 $7.50

*Paul O. Miller III**

One of the primary functions of the National Labor Relations Board is to conduct representation elections to determine whether employees desire union representation. In contrast to political elections, the employer's and the union's speech and conduct are closely regulated by the Board in an attempt to create "laboratory conditions" so that employees can exercise a "reasoned, untrammeled choice" for or against union representation. The Board's guidelines are premised upon certain assumptions as to employee behavior and the effect certain speech and conduct by the employer or union will have on that behavior. The result is the law of representation elections in which certain speech and conduct must be avoided or the election will be set aside.

In what evidently is a premier effort, the authors utilized two questionnaires to survey employees who voted in thirty-one representation elections in a cross-section of voting units. The initial questionnaire was employed during the interim between the union's card-signing campaign and the election campaign. The second was circulated subsequent to the election. This book is primarily a report of the authors' methods, results and conclusions.

Logically, the authors begin by succinctly stating the present law of representation elections and, more importantly for their purpose, the assumptions upon which the law is based. It was not the authors' intent to compile an extensive treatise on this area of the law, and readers should heed the caveat not to rely on this work for that purpose. Yet, the authors succeeded in establishing a sound basis for the ensuing presentation of the empirical data derived from the completed questionnaires and used to test the validity of the Board's assumptions.

The second chapter explains the methodology of the survey and recounts the empirical data compiled therein. In the discussion, probable biases resulting from the study's wholly midwestern and border states sample and from not administering the first questionnaire until after the union's card-signing campaign became evident. While the authors concluded that these facts do not impugn their results, their conclusions will not necessarily allay all skepticism, especially from those with a wealth of experience in representation election campaigns. Nevertheless, the authors should be commended for their valiant efforts to anticipate any fault in their study and consider its effect.

The next three chapters form the crux of the book. These chapters treat employee attitudes toward unions, employee predisposition to vote for union representation in a Board-conducted election and the effect of lawful and unlawful campaigning upon such a predisposition. While the division of subject mat-

* B.B.A. 1965, J.D. 1967, University of Mississippi; Partner, Jolly & Miller, Jackson, Mississippi.

ter into the effect of legal and illegal campaigning is a slight departure from the purpose of the book, the conclusion that both types of campaigning have the same effect is indeed provocative. Those readers who are persuaded that electioneering does *not* produce the desired effect will find it disappointing that the authors were unable to determine why a limited number of campaigns in the elections studied *did* change employees' predispositions.

Further departing from the book's objective, chapter six deals with the subject of union authorization cards. It is impossible to fault the authors for including this subject, however, because it is so entwined in the law of representation elections that its inclusion only increases the book's value to practitioners.

In the conclusion, the authors proceed to present their alternative to the present law, perhaps because of a guilt complex engendered by their subversion of a well-established body of Board law through the adroit wielding of their statistical sword. Since the alternative amounts to a hands-off posture by the Board, it is extremely doubtful that the Board will accept this study as conclusive proof that the bases for its decisions are invalid.

Thus, what is the value of this work? Probably its greatest value will be to those who advocate government deregulation as a stimulus to Board conducted studies. In the interim, it should provide food for thought to those responsible for conducting campaigns prior to representation elections and serve as ammunition for resourceful labor lawyers in challenging present Board law.

How to Take a Case Before the National Labor Relations Board

By Kenneth C. McGuiness
Washington, D.C.: Bureau of National Affairs
(4th ed. 1976). Pp. 535 $17.50

*Michael E. Earwood**

This "how to" manual is a thoroughly revised and considerably expanded edition of a work that has long been a standard authority in the field of NLRB practice and procedure. Authored by Kenneth C. McGuiness, former General Counsel of the NLRB, the book presents a clear and orderly explanation of the intricate procedural framework surrounding NLRB cases.

Following the format of previous editions, the book begins with a review of certain major provisions of the National Labor Relations Act, including sections relating to the Board's functions and structure, employer and union unfair labor practices, collective bargaining unit determination and jurisdictional standards. Numerous footnote citations to the Act, NLRB rules and regulations, and cases are especially helpful in supplementing the textual material and provide the reader with a ready reference to pertinent source materials. Also included are illustrative charts and tables explaining the organization of the Board, the Office of the General Counsel and the operation of various complex provisions of the Act.

After the initial overview is concluded, several chapters are devoted to a detailed analysis of the procedural aspects of handling representation cases. The discussion encompasses many components of the representation election process, including the selection of a bargaining agent, the mechanics of filing an election petition, contract-bar doctrines, *Excelsior* lists, preelection propaganda, consent-directed elections and post-election objection procedures. Although not intended as a comprehensive guide to conducting election campaigns, these chapters provide a wealth of information useful to both the practitioner unfamiliar with the representation election process and the experienced election tactician.

The book focuses next upon a detailed review of the procedural aspects of handling unfair labor practice charges. Well supported by footnote citation, the text succinctly discusses filing requirements and investigative procedures, even providing facsimilies of the forms and documents necessary to processing unfair labor practice cases. Additionally, the rules governing complaint hearings and post-hearing operations are provided in the event that the extensive discussion of settling a complaint without a hearing is disregarded.

The remaining chapters are devoted to a discussion of recognitional and organizational picketing, back-pay proceedings and jurisdictional dispute cases. The full text of the Labor Management Relations Act, the NLRB rules and regulations, and various directories of national, regional and district NLRB offices are set forth in the appendices.

A thorough, well-written treatise, this edition of *How to Take a Case Before*

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* B.B.A. 1973, J.D. 1976, University of Mississippi.

the National Labor Relations Board should be even more useful to labor practitioners than its predecessors. Whether used to familiarize executives and union officials with the Board's complicated procedural policies or as a research source for NLRB rules, regulations and procedures, this "how to" manual will be a valuable addition to the labor attorney's library.

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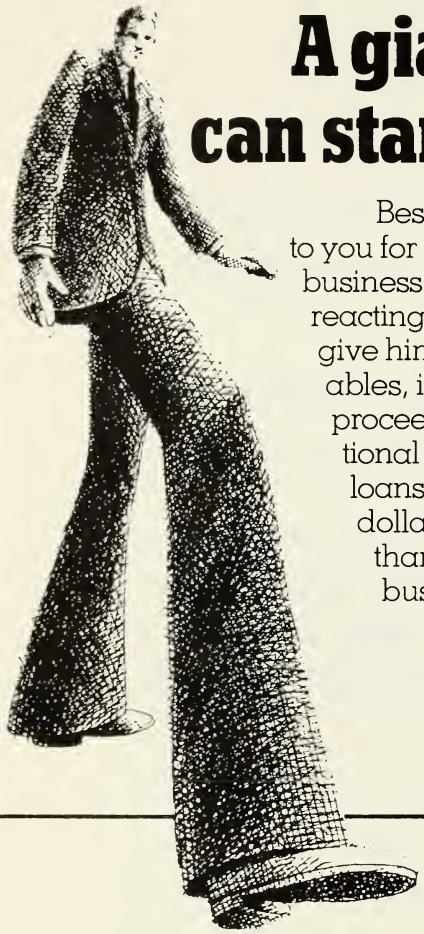

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